Reconciling the "Conflicting" Duties of Transfer Agents and Issuers Under the Securities Act and the Uniform Commercial Code

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INTRODUCTION

When a bank or other person undertakes to serve as transfer agent (and perhaps registrar[1]) for securities of a publicly-held[2] company, it acquires at least three different and potentially conflicting sets of legal responsibilities. First, under the applicable law of agency, the transfer agent will have fiduciary and other responsibilities to its principal, the issuer.[3] Second, under section 8-406 of the Uniform Commercial Code[4] (U.C.C.), the transfer agent will have a responsibility to the holder or owner of the securities to process the recordation of transfers of such securities in the manner required by the U.C.C., as well as a responsibility to the issuer to perform its transfer agency functions in good faith and with due diligence.[5] Third, as a participant in the process by which securities are issued and transferred,[6] the transfer agent has a responsibility to neither violate nor aid and abet the violation of the registration and prospectus delivery requirements of the Securities Act of 1933 (Securities Act).[7]

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1. The functions of the transfer agent and registrar are related, but different. The transfer agent's principal function is to maintain the issuer's security holder records by recording transfers of securities as they occur. *See* text accompanying note 19 *infra*. The registrar's principal function is to prevent the issuance by the issuer of securities in excess of the amount which it is authorized to issue. *See* 1 F. CHRISTY & R. APPEL, THE TRANSFER OF STOCK § 280 (5th ed. 1975) [hereinafter cited as 1 CHRISTY]; Folladori, *Bank Stock Transfer Agents: The Need to Shore Up Defenses*, 29 SW. L.J. 387, 388 (1975) [hereinafter cited as Folladori]; Johnson, *The Registrar and Transfer Agent—Child of the Securities Industry: Neglected or Indulged?*, 1971 UTAH L. REV. 308, 308 n.9 [hereinafter cited as Johnson].

2. Most corporations whose shares are publicly traded do not record transfers themselves but employ a transfer agent (usually a bank or trust company) to perform that function. Note, 103 PA. L. REV. 209, 209 n.3 (1954). While companies whose securities are closely held may engage a transfer agent, most do not since the limited number of transfers do not justify such an engagement. 1 CHRISTY, *supra* note 1, at § 279.

3. *See* text accompanying notes 33–49 *infra*.

4. U.C.C. § 8-406(1) (1978 version).

5. *See* text accompanying notes 50–63 *infra*.

6. The following assertion, made 15 years ago by a former member of the staff of the Securities and Exchange Commission, probably continues to summarize accurately the views of the staff:

> Under the Uniform Commercial Code . . . the recording of transfers [is] regarded as the performance of a mere ministerial function in recognition of the fact of transfer as between the parties.
>
> For Securities Act purposes, however, the Securities and Exchange Commission regards the act of recording a transfer on the issuer's records as an integral step in connection with the ultimate delivery of a security by a seller to a purchaser.

Weiss, *Investment and Control Securities—Problems of Transfer Agents and Transfer Departments*, 12 N.Y. L.F. 555, 556 (1966) (footnote omitted) [hereinafter cited as Weiss]. *See also* Folladori, *supra* note 1, at 393.

7. The Securities Act of 1933, 15 U.S.C. §§ 77a–77bbbb (1976) [hereinafter cited as Securities Act], is discussed in the text accompanying notes 90–165 *infra*. For differing views on the transfer agent's responsibilities under the Securities Act and its potential for aider and abettor liability, *compare* Bell and Arky, *Public Investor Protection and the Need for Regulation of Transfer Agents*, 26 BUS. LAW. 1649 (1971) [hereinafter cited as Bell and Arky]; Johnson, *supra* note 1; *and* Weiss, *supra* note 6; *with* Hoblin and Kelly, *Registration of Transfer of Restricted Securities Under the Uniform Commercial Code: A Conflict of Law With the Securities Act of 1933*, 25 MERCER L. REV. 581 (1974) [hereinafter cited as Hoblin and Kelly].

In the relatively few years since the adoption of the U.C.C. by the states,[8] commentators[9] have noted an apparent conflict between the transfer agent's duty under Article 8 of the U.C.C. to process the recordation[10] of transfers and its duty under the Securities Act to avoid violating or aiding and abetting the violation of the registration and prospectus delivery requirements of that statute.[11] Cases have suggested that there can be a conflict between these respective statutory duties of the transfer agent,[12] and that when such a conflict arises the transfer agent can refuse to fulfill its duty to process the recordation of transfers under Article 8 of the U.C.C.[13] In addition, the staff of the Securities and Exchange Commission (Commission) has indicated, in no-action letters[14] and otherwise, that in its view a transfer agent is obligated to refuse to fulfill that duty if the transfer agent has reason to know that a violation of the registration and prospectus delivery requirements will occur in connection with transfers or transactions to be processed by it.[15]

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8. The original version of the Uniform Commercial Code was promulgated in 1951 and enacted in Pennsylvania in 1953, effective July 1, 1954. *See* U.C.C., General Comment. One or another of the several subsequent versions of the U.C.C. has since been enacted in all of the other states and in the District of Columbia, with the great bulk of such enactments occurring between 1958 and 1967. *See* U.C.C., Forward to 1978 Text and Comments.

9. *See, e.g.*, Bell and Arky, *supra* note 7; Folladori, *supra* note 1, at 393; Hoblin and Kelly, *supra* note 7.

10. While the U.C.C. speaks in terms of "registering" transfers rather than "recording" them, this Article will employ the latter term in an attempt to avoid confusion with the concept of registration as used in the Securities Act, a concept which is dramatically different from registration of a transfer under the U.C.C. *See* text accompanying notes 90–93 *infra*.

11. The registration and prospectus delivery requirements of the Securities Act are set out in § 5 thereof, 15 U.S.C. § 77e (1976).

12. *See, e.g.*, Melville v. Wantschek, 403 F. Supp. 439 (E.D.N.Y. 1975); Travis Inv. Co. v. Harwyn Publishing Corp., 288 F. Supp. 519 (S.D.N.Y. 1968); Charter Oak Bank & Trust Co. v. Register & Transfer Co., 141 N.J. Super. 425, 358 A.2d 505 (1976); Branerton Corp. v. United States Corp. Co., 34 A.D.2d 1, 309 N.Y.S.2d 28 (1970).

13. If there were a true conflict between the transfer agent's duties under federal law, such as the Securities Act, and state law, such as the U.C.C., the transfer agent would of course be obligated to adhere to the requirements of federal law. U.S. CONST. art. VI, § 2 (supremacy clause). *See* Bell and Arky, *supra* note 7, at 1661; Weiss, *supra* note 6, at 564.

14. A no-action letter is a statement by the staff that it will not recommend to the Commission that enforcement proceedings be instituted in specified circumstances. Such letters are usually issued only in response to letters of inquiry, submitted with respect to specific, nonhypothetical transactions, which describe the proposed transaction in detail and set forth the requestor's analysis and opinion as to the application of the federal securities laws to the transaction. A no-action letter, if issued, inures only to the benefit of the party to whom it is addressed; is not binding on the Commission or on the courts; is binding on the staff only to the extent that the facts stated in the letter of inquiry remain accurate; and is not supposed to have precedential value. These disclaimers and limitations notwithstanding, other parties do rely on prior no-action letters as precedent and as some indication of the view of the Commission; and enforcement proceedings are virtually never instituted by the Commission in respect of transactions on which a no-action letter has been issued. *See* Kenler v. Canal Nat'l Bank, 489 F.2d 482, 487 (1st Cir. 1973); Riskin v. National Computer Analysts, Inc., 62 Misc. 2d 605, 607, 308 N.Y.S.2d 985, 987 (1970), *modified*, 37 A.D.2d 952, 326 N.Y.S.2d 419 (1971); Doliner v. Eastern Can Co., 62 Misc. 2d 555, 559, 309 N.Y.S.2d 249, 253 (Sup. Ct. 1965). *See also* Folladori, *supra* note 1, at 396 n.59.

For a brief criticism of the use of no-action letters as precedent and an indication of the Commission's views, *see* R. JENNINGS & H. MARSH, SECURITIES REGULATION—CASES AND MATERIALS 33 (4th ed. 1977) [hereinafter cited as JENNINGS & MARSH].

15. No-action letter issued to Defrees, Fiske, Voland, Alberts & Hoffman, [1971–72 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 78,745 (available April 12, 1972). *See also* Bell and Arky, *supra* note 7, at 1661; Weiss, *supra* note 6, at 556; no-action letter issued to Argus, Inc., [1979 Transfer Binder] FED. SEC. L. REP. (CCH) § 81,930 (available November 18, 1978).

Despite the rather substantial volume of commentary, cases, and staff comment on the subject of the relationship of the transfer agent's duties under the Securities Act and its duties under Article 8 of the U.C.C., Christy and Appel's leading treatise on the law of stock transfers continues to characterize this subject as being "in a state of confusion."[16] Furthermore, none of the law review commentaries, cases, or staff positions have yet focused on another area of responsibility previously identified—the responsibility of the transfer agent to its issuer–principal under agency principles—or sought to analyze the effect that it may have upon the interplay between the transfer agent's duties under the U.C.C. and its duties under the Securities Act.

This Article will attempt to eliminate some of the confusion in the cases dealing with the interplay of the transfer agent's responsibilities under the Securities Act and under Article 8 of the U.C.C. The Article will begin in Part I by (1) describing briefly the role that the transfer agent plays and the way the transfer agent's operations are conducted to fulfill that role; (2) summarizing the way in which the issuer and its transfer agent establish an agency relationship; (3) outlining certain of the pertinent duties and responsibilities that the transfer agent owes to the issuer as a result of the agency nature of their relationship; (4) outlining the duties that the transfer agent owes to the issuer and to the owner or holder of the securities under Article 8 of the U.C.C.; and (5) describing the registration and prospectus delivery requirements of the Securities Act, certain of the exemptions, and the way in which a party might aid and abet a violation of those requirements of that Act. The Article will then examine in Part II a number of common situations in which the transfer agent is involved, for the purpose of determining, in each such situation, if there really is any conflict between, on the one hand, the transfer agent's duties under Article 8 and agency principles and, on the other hand, the transfer agent's duty to avoid violating or aiding and abetting the violation of the registration and prospectus delivery requirements of the Securities Act. Next, the Article will examine in Part III the results of the "confused cases" dealing with the interplay of Article 8 of the U.C.C. and the Securities Act to see if these results are consistent with the conclusions reached in Part II as to the conflict or lack of conflict between the three areas of responsibility. Finally, in Part IV the Article will discuss the question of whether transfer agents should be obligated to assist the Commission in the enforcement of the Securities Act's registration and prospectus delivery provisions.

I. TRANSFER AGENT—THE ROLE AND THE LAW

A. *The Role of the Transfer Agent*

Because a large volume of securities of publicly-held companies are transferred, particularly on the national securities exchanges and in the over-

16. 1 CHRISTY, *supra* note 1, at § 51(a).

the-counter market, there exists a need for efficient, quick, and relatively inexpensive procedures by which these transfers can be implemented and recorded.[17] The implementation of the transfer of stock or securities from one owner to another is usually handled by brokers on the exchange markets, in which brokers act as agents for the buyer and seller in matching the purchase and sale orders, or by a dealer in the over-the-counter market in which the dealer, acting as principal rather than agent, sells securities to or buys securities from the customer for the dealer's own account.[18] Less frequently the transfer of the securities is implemented by the principals themselves without the intervention of a broker.

While the transfer of securities in a purchase or sale transaction is accomplished by the parties to the transaction or their brokers, the transfer agent's main function is to implement the *recordation* of these transfers on the issuer's books and records[19] and to do so quickly so that the records of the issuer, the brokers, and their customers as to the ownership of the securities are kept up to date.[20] Although there is no requirement that an issuer engage a transfer agent to perform this recordation function,[21] most publicly held issuers employ professional transfer agents to perform the function since such professionals are usually more efficient than the issuer.[22]

In addition to performing their main task of recording transfers and issuances of securities, transfer agents often are called upon to prepare and certify security holder lists as of specified record dates; to mail meeting and other notices and proxy material to the security holders; to attend security holders meetings (and sometimes to serve there as inspector of elections); to disburse cash and stock dividends; and generally to assist the issuer in its relationships with its security holders.[23] In addition, the company which is employed as transfer agent will often be employed by the issuer to serve in other capacities such as registrar, dividend reinvestment plan agent, warrant agent and authenticating trustee for debt issues.[24] However, since the basic role of the transfer agent is to record transfers,[25] it is that role on which this Article will focus.

In performing this basic role, the transfer agent's activities are ministerial

17. *Id.* § 279; Folladori, *supra* note 1, at 388.

18. *See* N.Y. U.C.C. § 8-301, Practice Commentary (McKinney 1964); *See also* C. ISRAELS & E. GUTTMAN, MODERN SECURITIES TRANSFERS § 4.10 (rev. ed. 1971 & 1980 Cum. Supp.) [hereinafter cited as ISRAELS & GUTTMAN].

19. 1 CHRISTY, *supra* note 1, at § 279; Folladori, *supra* note 1, at 388; Johnson, *supra* note 1, at 308 n.10. *See also* U.C.C. § 8-401, Official Comment 3, together with U.C.C. § 8-406(1)(b).

20. The so-called "turn around" rules, promulgated by the Commission under the Securities Exchange Act of 1934, Section 17A(d)(1), 15 U.S.C. § 78g-1(d)(1) (1976), require all transfer agents that are registered as such under that Act to complete the recordation of transfers and the issuance of new certificates to the transferee within the time limits of those rules. 17 C.F.R. § 240.17Ad-2 (1981).

21. *See* U.C.C. § 8-401.

22. 1 CHRISTY, *supra* note 1, at § 279; Folladori, *supra* note 1, at 388. *See also* Israels and Guttman, *The Transfer Agent and the Uniform Commercial Code*, 21 BUS. LAW. 981 (1966).

23. 1 CHRISTY, *supra* note 1, at § 279; Folladori, *supra* note 1, at 388; Johnson, *supra* note 1, at 308 n.10.

24. An "authenticating trustee" is, with respect to public debt issues, the functional equivalent of a transfer agent. ISRAELS & GUTTMAN, *supra* note 18, at § 7.03.

25. *See* U.C.C. § 8-401, Official Comment 3, together with U.C.C. § 8-406. *See also* note 19 *supra*.

in nature, not judgmental.[26] Because the transfer agent, as an agent of the issuer,[27] is generally bound to follow the instructions of its principal,[28] it rarely brings its judgment to bear on whether or not transfers should or should not be recorded,[29] or whether or not legends restricting transfer should be imposed or removed. On matters such as these it usually follows the directions of its principal, as an agent is bound to do.[30]

Although it has been asserted by certain commentators[31] that the duties of the transfer agent are more than ministerial, this assertion fails to recognize the agency relationship between the issuer and the transfer agent and the effect of that relationship upon the nature of the agent's duty: as an agent the transfer agent can rarely, if ever, substitute its judgment for the instructions of its principal.[32]

Because of the ministerial, limited-judgmental nature of their role, transfer agents are often staffed largely by relatively uneducated persons, whose compensation reflects the ministerial, mechanical nature of their function. Therefore, transfer agents' costs and fees are presumably substantially less than they would become if legions of lawyers and skilled securities professionals were to replace or augment the ranks of clerks who perform the bulk of the recordation function.

B. *The Establishment of the Agency Relationship*

Most transfer agency relationships are established either by written agreement between the issuer and the transfer agent or by the adoption by the issuer of corporate resolutions. [33] Corporate resolutions, among other things, authorize the transfer agent to record transfers of the issuer's securities, specify the officers of the issuer whose instructions are to be followed by the agent, spell out the rights and duties of the issuer and of the agent, and provide for the indemnification of the agent by the issuer for loss potentially suffered by it in the course of the relationship.[34] Such an express agreement or corporate resolution constitutes a "manifestation of consent" that the transfer agent shall act for and be subject to the direction and control of the issuer

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26. Weiss, *supra* note 6, at 556. *See also* Affiliated Ute Citizens v. United States, 406 U.S. 128, 149 (1972), in which the United States Supreme Court recognized that transfer agents perform an essentially ministerial, rather than judgmental, function.

27. *See* text accompanying notes 35–37 *infra*.

28. *See* text accompanying notes 41–48 *infra*.

29. The transfer agent does, of course, initially determine that the requirements which are set out in U.C.C. § 8-401 have been met, thereby imposing the obligation to record the transfer on the issuer and the agent. However, if there is any question as to whether these requirements have been met, so that recordation may not be required or proper, the transfer agent should consult with its principal for instructions. *See* text accompanying notes 48–50 *infra*. *See also* 1 CHRISTY, *supra* note 1, at § 51.

30. *See* text accompanying notes 48–50 *infra;* 1 CHRISTY, *supra* note 1, at § 51.

31. Bell and Arky, *supra* note 7; Johnson, *supra* note 1. *See also* no-action letter issued to Defrees, Fiske, Voland, Alberts & Hoffman, [1971–72 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 78,745 (available April 12, 1972).

32. *See* notes 41–49 *infra* and accompanying text.

33. 1 CHRISTY, *supra* note 1, at § 282; Folladori, *supra* note 1, at 388.

34. *See* note 33 *supra*.

in recording transfers of securities and in executing other tasks covered by the agreement or resolution.[35] Therefore, such an agreement or resolution typically creates an agency relationship in which the principal is the issuer and the agent is the transfer agent.[36]

The relationship which results is governed by the common law or code rules of agency[37] since an agency relationship is involved, and by the rules of Section 8-406 of the U.C.C., since a transfer agency is involved.[38] However, it is important to note that Section 8-406 supplements, but does not supplant, the common law and code rules of agency.[39] Thus, even though the transfer agent is subject to the rules of Section 8-406 of the U.C.C., it continues to be governed as well by the rules of agency law.[40]

C. *The Duties of an Agent to its Principal*

When an agency relationship is created, the agent becomes a fiduciary of its principal as to matters within the scope of its agency.[41] Thus, the transfer agent, as agent of the issuer, owes fiduciary duties to the issuer, including the duty to treat the issuer fairly in all matters.[42]

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35. *See* RESTATEMENT (SECOND) OF AGENCY § 1 (1958), which provides:

(1) Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act.

(2) The one for whom action is to be taken is the principal.

(3) The one who is to act is the agent.

36. 1 CHRISTY, *supra* note 1, at § 281; Guttman, *Investment Securities Under the Uniform Commercial Code*, 11 BUFFALO L. REV. 1, 40 (1962). *See also* CAL. CIV. CODE §§ 2295, 2296, 2299 (West 1954), which respectively provide "An agent is one who represents another, called the principal, in dealings with third persons. Such representation is called agency. . . . Any person having capacity to contract may appoint an agent, and any person may be an agent. . . . An agency is actual when the agent is really employed by the principal."

37. Guttman, *Investment Securities Under the Uniform Commercial Code*, 11 BUFFALO L. REV. 1, 40–41 (1962). *See also* 1 CHRISTY, *supra* note 1, at § 281.

38. U.C.C. § 8-406 provides:

(1) If a person acts as authenticating trustee, transfer agent, registrar, or other agent for an issuer in the registration of transfers of its certificated securities or in the registration of transfers, pledges, and releases of its uncertificated securities, in the issue of new securities, or in the cancellation of surrendered securities:

(a) he is under a duty to the issuer to exercise good faith and due diligence in performing his functions; and

(b) with regard to the particular functions he performs, he has the same obligation to the holder or owner of a certificated security or to the owner or pledgee of an uncertificated security and has the same rights and privileges as the issuer has in regard to those functions.

(2) Notice to an authenticating trustee, transfer agent, registrar or other agent is notice to the issuer with respect to the functions performed by the agent.

In certain circumstances this section provides the owner or holder of securities with a direct cause of action against the transfer agent.

39. *See* U.C.C. § 1–103, which provides in pertinent part: "Unless displaced by the particular provisions of this Act, the principles of law and equity, including . . . the law relative to . . . principal and agent . . . shall supplement its provisions." *See also* U.C.C. § 8–406, Official Comment 1; Welland Inv. Corp. v. First Nat'l Bank of Jersey City, 81 N.J. Super. 180, 187, 195 A.2d 210, 214 (1963); Guttman, *Investment Securities Under the Uniform Commercial Code*, 11 BUFFALO L. REV. 1, 40 (1962).

40. *See* note 39 *supra*.

41. RESTATEMENT (SECOND) OF AGENCY § 13 (1958).

42. RESTATEMENT (SECOND) OF AGENCY § 13, Comment a (1958).

In addition to this general fiduciary duty which a transfer agent owes its issuer-principal, it owes other specific duties to its principal under the rules of agency.[43] Among these are the duty to follow the principal's instructions,[44] since the agent must at all times remain subject to the principal's control;[45] the duty to refrain from taking action other than that which the agent reasonably believes that the principal desires under the circumstances;[46] and the duty to comply with the terms of the contract which created the transfer agency relationship,[47] unless the circumstances are such that the agent reasonably believes that the issuer-principal would now desire that it do something different from that called for by the contract.[48]

Among the other duties imposed on the agent under the law of agency is the duty to transmit to the principal information which comes to the agent's attention and which the principal would desire to receive.[49] This duty, if fulfilled by the agent, will permit the issuer to evaluate the information and then give express instructions to the agent, which is preferable to leaving the agent to reasonably infer from the information what the issuer would want done in the circumstances. If the transfer agent cannot fulfill any of its duties, its only alternative is to terminate the agency relationship and thereby terminate the duty.

The relationship of these agency duties to those imposed by Article 8 of the U.C.C. and by the Securities Act will be discussed herein. The fundamental point to keep in mind, however, throughout the remainder of the discussion is that the transfer agent is an agent, bound to follow its principal's instructions—whether those instructions are given in, or subsequent to, the original contract or resolution creating the agency—and bound to turn to its

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43. *Id. See also* RESTATEMENT (SECOND) OF AGENCY §§ 387–431 (1958).

44. *See* RESTATEMENT (SECOND) OF AGENCY § 385 (1958), which provides:

> (1) Unless otherwise agreed, an agent is subject to a duty to obey all reasonable directions in regard to the manner of performing a service that he has contracted to perform.
>
> (2) Unless he is privileged to protect his own or another's interests, an agent is subject to a duty not to act in matters entrusted to him on account of the principal contrary to the directions of the principal, even though the terms of the employment prescribe that such directions shall not be given.

But see CAL. CIV. CODE § 2320 (West 1954), which provides: "An agent has power to disobey instructions in dealing with the subject of the agency, in cases where it is clearly for the interest of his principal that he should do so, and there is not time to communicate with the principal."

45. RESTATEMENT (SECOND) OF AGENCY § 14 (1958), provides: "A principal has the right to control the conduct of the agent with respect to matters entrusted to him."

46. *Id.* § 33, which provides: "An agent is authorized to do, and to do only, what it is reasonable for him to infer that the principal desires him to do in the light of the principal's manifestations and the facts as he knows or should know them at the time he acts." *See also id.*, Comment a.

47. *See* RESTATEMENT (SECOND) OF AGENCY § 377 (1958), which provides: "A person who makes a contract with another to perform services as an agent for him is subject to a duty to act in accordance with his promise."

48. *Id.* § 33, which is set out in note 46 *supra*. *Cf.* CAL. CIV. CODE § 2320 (West 1954), which is set out in note 44 *supra*, and provides that an agent may disobey its principal's orders only where two conditions are met: (1) that the disobedience is clearly in the interest of the principal; and (2) that there is no time to communicate with the principal.

49. RESTATEMENT (SECOND) OF AGENCY § 381 (1958), provides:

> Unless otherwise agreed, an agent is subject to a duty to use reasonable efforts to give his principal information which is relevant to affairs entrusted to him and which, as the agent has notice, the principal would desire to have and which can be communicated without violating a superior duty to a third person.

principal for instructions, whenever possible, if the agent has facts which lead it to believe that a departure from existing instructions is appropriate.

D. *Duties of the Transfer Agent Under Article 8 of the U.C.C.*

Under the U.C.C., the transfer agent owes to its issuer-principal the duty of "good faith and due diligence in performing his functions. . . ."[50] While this provision merely restates in the U.C.C. a "long established principle of the law of agency,"[51] the inclusion of this provision in Article 8 does make clear that the transfer agent's fulfillment of its duties to the owner or holder of securities under the U.C.C. must be tempered by its duty to its issuer-principal.[52] Good faith[53] on the part of the transfer agent would presumably include a willingness to comply with the instructions of the issuer-principal, which may conflict with the duty of the transfer agent to the securities owner.[54]

The official comments to the U.C.C. make clear that the transfer agent must, because of its duty to the issuer, record transfers of securities when it is commercially reasonable to do so in the circumstances. Furthermore, arbitrary, capricious, over-cautious and supertechnical objections or conditions to the recordation of the transfer cannot be imposed.[55] Indeed, it has been frequently asserted that the principal purpose of Article 8 is to facilitate commercial trade in investment securities by imbuing them with the characteristics of negotiable instruments,[56] thereby precluding issuers and transfer agents from continuing to engage in the formerly-common practice of refusing to transfer securities until reams of paperwork had been accomplished and many technical objections had been overcome.[57]

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50. U.C.C. § 8-406(1)(a).

51. N.Y. U.C.C. § 8-406, Practice Commentary (McKinney 1964).

52. U.C.C. § 8-406(1)(b) provides: "With regard to the particular functions he performs, [the transfer agent] has the same obligation to the holder or owner of a . . . security . . . and has the same rights and privileges as the issuer has in regard to those functions."

53. "Good faith" is defined in U.C.C. § 1-201(19) as "honesty in fact in the conduct or transaction concerned."

54. Of course, where a transfer agent refuses to fulfill a duty to the owner or holder of securities, it will be exposed to liability to such owner-holder, even if the refusal is based on the instructions of the principal. However, in such a case, the agent should be able to look to his principal for indemnification for any loss which it actually suffers. *See* N.Y. U.C.C. § 8-406, Practice Commentary (McKinney 1964).

55. *See* U.C.C. § 8-406, Official Comment 3.

56. Bell and Arky, *supra* note 7, at 1660; Folladori, *supra* note 1, at 389; Guttman, *Investment Securities Under the Uniform Commercial Code*, 11 BUFFALO L. REV. 1, 1 (1962); Israels, *Stop-Transfer Procedures and the Securities Act of 1933—Addendum to Uniform Commercial Code—Article 8*, 17 RUTGERS L. REV. 158, 158 (1962); Weiss, *supra* note 6, at 555.

57. *See* Note, 103 U. PA. L. REV. 209, 209–10 (1954); Note, 11 HOUS. L. REV. 999, 1000–01 (1974). This practice was employed because issuers formerly viewed the transfer of securities as most hazardous. As Professor Guttman has written, this situation was caused by dictum of Chief Justice Taney in Lowry v. Commercial & Farmers' Bank 15 F. CAS. 1040 (C.C.D. Md. 1848) (No. 8, 581), which,

> set off a chain reaction which made the transfer of securities a most hazardous and, as a result, most expensive adventure. Referring to the corporate issuer of investment securities, Taney, C.J., stated that it was ". . . the custodian of the shares of stock, and clothed with power sufficient to protect the rights of everyone interested, from unauthorized transfers; it is a trust placed in the hands of the corporation for the protection of individual interests, and like every other trustee, it is bound to execute the trust with proper diligence and care, and is responsible for any injury sustained by its negligence or misconduct." Holding that wills are registered public documents, the learned Chief

It is presumably for this reason[58] that Section 8-401 of the U.C.C.[59] imposes on the issuer the duty to record a transfer of a security, if the recordation request meets relatively few conditions. This duty is also imposed upon the transfer agent, for the benefit of the owner or holder of the securities, by Section 8-406(1)(b) of the U.C.C.[60] If upon a proper request for recordation under Sections 8-401 and 8-406,[61] the issuer or transfer agent fails to fulfill its duty to record, or to timely record, it will be liable to the holder or owner for any loss resulting from such failure.[62]

However, before the issuer or transfer agent becomes subject to the duty to record a transfer, the conditions set forth in Section 8-401 of the U.C.C. must have been satisfied or waived by the issuer.[63] These conditions are (1) that the security be appropriately endorsed;[64] (2) that there be reasonable assurance that the endorsements are effective and genuine;[65] (3) that any duty of the issuer to inquire into adverse claims has been satisfied;[66] (4) that any applicable tax collection laws have been complied with;[67] and (5) that the transfer of the security involved was *either* "rightful" *or* to a "bona fide purchaser" (BFP).[68]

Justice came to the conclusion that a corporation transferring a security contrary to a will would be liable in breach of trust.

Guttman, *Investment Securities Under the Uniform Commercial Code*, 11 BUFFALO L. REV. 1, 3-4 (1962). *See also* Israels, *How to Handle Transfers of Stock, Bonds and Other Investment Securities*, 19 BUS. LAW. 90, 91 (1963).

58. *See* U.C.C. § 8-406, Official Comment 3.

59. U.C.C. § 8-401 provides as follows:

(1) If a certificated security in registered form is presented to the issuer with a request to register transfer or an instruction is presented to the issuer with a request to register transfer, pledge, or release, the issuer shall register the transfer, pledge, or release as requested if:

(a) the security is indorsed or the instruction was originated by the appropriate person or persons (Section 8-308);

(b) reasonable assurance is given that those indorsements or instructions are geniune and effective (Section 8-402);

(c) the issuer has no duty as to adverse claims or has discharged the duty (Section 8-403);

(d) any applicable law relating to the collection of taxes has been complied with; and

(e) the transfer, pledge, or release is in fact rightful or is to a bona fide purchaser.

(2) If an issuer is under a duty to register a transfer, pledge, or release of a security, the issuer is also liable to the person presenting a certificated security or an instruction for registration or his principal for loss resulting from any unreasonable delay in registration or from failure or refusal to register the transfer, pledge, or release.

60. U.C.C. § 8-406 is set out in note 38 *supra*. *See also* note 52 *supra*.

61. *See* text accompanying notes 64-68 *infra* for a description of a proper request.

62. U.C.C. §§ 8-401(2) and 8-406(1)(b).

63. U.C.C. § 8-401, Official Comment 3.

64. U.C.C. § 8-401(1)(a). *See also* U.C.C. § 8-308 which sets out the requirements for and types of endorsements.

65. U.C.C. § 8-401(1)(b). *See also* U.C.C. § 8-402 dealing with the types of assurances which may be required.

66. U.C.C. § 8-401(1)(c). *See also* U.C.C. § 8-302(2) defining the term "adverse claim."

67. U.C.C. § 8-401(1)(d).

68. *Id.* § 8-401(1)(e). *See also* U.C.C. § 8-302(1) defining the term "bona fide purchaser." Neither "rightful" nor "wrongful" is defined in the U.C.C. In addition, the U.C.C. does not define "transfer," a concept which roughly corresponds to the term "assign," which is customarily used in the securities industry and in some statutes. Folk, *Article 8: A Premise and Three Problems*, 65 MICH. L. REV. 1379, 1398 n.74 (1967) [hereinafter cited as Folk].

Under Section 8-403,[69] an issuer is under a duty to inquire into an adverse claim if it receives written notice of that claim in time to permit it a reasonable opportunity to act on the claim before it records the requested transfer. The transfer agent of the issuer is also subject to this duty under Section 8-406.[70] Since Section 8-302[71] defines "adverse claim" to include a claim that a transfer of securities is wrongful, and since transfers in violation of the registration and prospectus delivery requirements of the Securities Act have been asserted to be "wrongful,"[72] the transfer agent will have, at least arguably, notice of an adverse claim and the resulting duty of inquiry when the issuer notifies it in writing that the securities are subject to Securities Act restrictions on transfer.[73] Such notification from the issuer could be given by the imposition of stop transfer instructions or the imposition of a legend on the securities themselves setting out the restrictions.[74]

If an issuer or transfer agent has a duty of inquiry with respect to an adverse claim, it may discharge that duty by any reasonable means—one of which is specified in the U.C.C.[75]—but it must do so with due diligence.[76] In the usual case, however, the issuer or transfer agent will employ the method of inquiry specified in the U.C.C., which is to notify the adverse claimant[77] that recording of the transfer has been requested; that it will be delayed for thirty days to permit the adverse claimant to obtain an injunction or restraining order preventing the recordation of transfer or, in the alternative, an indemnity bond acceptable to the issuer or transfer agent; and that if neither is obtained in thirty days, the transfer will be recorded. Thus, notice of an

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69. U.C.C. § 8-403(1).

70. *Id.* § 8-406(1)(b).

71. *Id.* § 8-302(2), which provides: " 'Adverse claim' includes a claim that a transfer was or would be wrongful or that a particular adverse person is the owner of or has an interest in the security."

72. Haley, *Investment Securities*, 34 BUS. LAW. 1535, 1537–39 (1979); Israels, *How to Handle Transfers of Stock, Bonds and Other Investment Securities*, 19 BUS. LAW. 90, 94 (1963); Israels, *Stop Transfer Procedures and the Securities Act of 1933—Addendum to Uniform Commercial Code—Article 8*, 17 RUTGERS L. REV. 158, 165 (1962). *See also* ISRAELS & GUTTMAN, *supra* note 18, at § 4.06.

73. Israels & Guttman, *The Transfer Agent and the Uniform Commercial Code*, 21 BUS. LAW. 981, 988–90 (1966). *See also* U.C.C. § 8-204, Official Comment 5.

It should be noted, however, that under U.C.C. § 8-302(2) an adverse claim will not arise unless it is claimed that a transfer is or will be wrongful (or that a particular adverse person is the owner of or has an interest in the security). Thus, instructions from the issuer to the transfer agent to refuse to record certain transfers may not constitute an adverse claim where the instructions are not clearly based upon the issuer's concern that the transfer is or will be in violation of the Securities Act. Kanton v. United States Plastics, Inc., 248 F. Supp. 353, 358–59 (D.N.J. 1965).

74. If restrictions on the transferability of the securities are imposed by the issuer, either by stop transfer instructions to the transfer agent or by legending the certificates, such restrictions will be ineffective unless (a) they are *conspicuously* noted on the certificates or (b) the person against whom the restriction is to be enforced has actual knowledge of the unnoted restriction. U.C.C. § 8-204. If securities which are subject to an unnoted restriction on transfer are sold to a person with no actual knowledge of it, the restriction will be ineffective against the purchaser, and if the issuer and transfer agent refuse to record the transfer to him, he will be able to collect damages from them. Edina St. Bank v. Mr. Steak, Inc., 487 F.2d 640 (10th Cir.), *cert. denied*, 419 U.S. 883 (1974), which is discussed in the text accompanying notes 252–56 *infra*. For criticism of the opinion (but not the result) in *Edina*, *see* Folladori, *supra* note 1, at 398–400; Note, 11 HOUS. L. REV. 999, 1006–08 (1974).

75. U.C.C. § 8-403(2).

76. *Id.* § 8-406(1)(a).

77. In the case of a restriction on transfer imposed by the issuer to prevent future securities law violations, the adverse claimant is, of course, the issuer. *See* text accompanying notes 71–74 *supra*.

adverse claim justifies a thirty day delay in the recordation of transfer, since that is a reasonable period for inquiring into the adverse claim, but does not justify refusal to record indefinitely unless the investigation reveals that the transfer is neither rightful nor to a BFP. If the transfer that is sought to be recorded is neither rightful nor to a BFP, the transfer agent or issuer may refuse to record indefinitely, without liability, since Section 8-401[78] provides that the duty to record a transfer is conditioned upon the transfer being either rightful or to a BFP.[79]

Even if a transfer is wrongful, as a violation of the Securities Act[80] or otherwise, the transfer agent or issuer must still record it (or be exposed to liability in damages to the owner-holder[81]) if the transfer is to a bona fide purchaser within the meaning of Section 8-302(1) of the U.C.C.[82] Under that Section, a BFP includes a purchaser for value who takes delivery of a certificated security in good faith and without notice of any adverse claim.[83] Under Section 1-201(14) of the U.C.C., delivery of a certificated security occurs when there is a voluntary transfer of possession; and under Section 8-313 a

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78. U.C.C. § 8-401(1)(e).

79. As previously noted, neither "rightful" nor "wrongful" nor "transfer" is defined in the U.C.C. *See* Folk, *supra* note 68, at 1398 n.74 (1967). "Bona fide purchaser," referred to in this Article as "BFP," is defined in U.C.C. § 8-302(1) as follows:

> A "bona fide purchaser" is a purchaser for value in good faith and without notice of any adverse claim:
>
> (a) who takes delivery of a certificated security in bearer form or in registered form, issued or indorsed to him or in blank;
>
> (b) to whom the transfer, pledge, or release of an uncertificated security is registered on the books of the issuer; or
>
> (c) to whom a security is transferred under the provisions of paragraph (c), (d)(i), or (g) of Section 8-313(1).

80. *See* text accompanying notes 91–149 *infra* for a discussion of the Securities Act.

81. *See* U.C.C. §§ 8-401(2) and 8-406(1)(b).

82. U.C.C. § 8-401(1)(e).

83. The terms "purchase," "purchaser," "value," "good faith," and "delivery" are defined in U.C.C. § 1-201 as follows:

> (14) "Delivery" with respect to instruments, documents of title, chattel paper, or certificated securities means voluntary transfer of possession.
>
> . . . .
>
> (19) "Good faith" means honesty in fact in the conduct or transaction concerned.
>
> . . . .
>
> (32) "Purchase" includes taking by sale, discount, negotiation, mortgage, pledge, lien, issue or reissue, gift or any other voluntary transaction creating an interest in property.
>
> (33) "Purchaser" means a person who takes by purchase.
>
> . . . .
>
> (44) "Value". Except as otherwise provided with respect to negotiable instruments and bank collections (Sections 3-303, 4-208, and 4-209) a person gives "value" for rights if he acquires them
>
> (a) in return for a binding commitment to extend credit or for the extension of immediately available credit whether or not drawn upon and whether or not a charge-back is provided for in the event of difficulties in collection; or
>
> (b) as security for or in total or partial satisfaction of a pre-existing claim; or
>
> (c) by accepting delivery pursuant to a pre-existing contract for purchase; or
>
> (d) generally, in return for any consideration sufficient to support a simple contract.

The terms "security" and "certificated security" are defined in U.C.C. § 8-102, and the term "adverse claim" (which is discussed in the text accompanying notes 69–77 *supra*) is defined in U.C.C. § 8-302(2).

transfer of the security, as opposed to the recordation or registration of that transfer, occurs at the time that the purchaser or his designee comes into possession of the certificated security.[84]

Thus, in the case of securities which are represented by certificates,[85] usually both delivery and transfer occur at the time the certificate, appropriately endorsed by the seller, is received by the purchaser or his broker.[86] If at this time a purchaser for value is acting in good faith and without notice of any adverse claim, his later request for recordation of the transfer must be honored by the issuer and transfer agent[87] even if the transfer was "wrongful." Again it should be noted that the transfer, whether rightful or wrongful, takes place at the time of delivery of the endorsed certificate; it will have been accomplished before the transfer is *recorded,* at which time the endorsed certificate will be cancelled and a new certificate will be issued in the name of the purchaser.[88]

In summary, then, under the U.C.C. the transfer and delivery of a security occur before the recordation of that transfer; the transfer agent has a duty to record transfers, even when the transfer itself is wrongful, if at the time of delivery the purchaser was acting in good faith and without knowledge of any adverse claim. Failure to satisfy this duty will render the transfer agent and issuer liable to the owner-holder of the securities.

E. *The Requirements of the Securities Act of 1933*

Unlike the U.C.C., which is "uniform" state legislation adopted in at least similar form in virtually every state of the union,[89] the Securities Act is a federal statute enacted in 1933 in an effort to provide adequate information to securities investors throughout the nation so that informed investment decisions can be made.[90] The heart of the Securities Act is the disclosure obligation, set forth in Section 5,[91] which generally requires that the issuer of securi-

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84. U.C.C. §§ 8-313(1)(a); 8-313(1)(c); 8-313(4).

85. Article 8 of the U.C.C. makes provision in § 8-102 for both certificated and uncertificated securities, looking to the day in the future when the "certificateless society" becomes a reality. *See* Hoblin and Kelly, *supra* note 7, at 598–99; *cf.* U.C.C., Foreword to 1978 Official Text & Comments.

86. ISRAELS & GUTTMAN, *supra* note 18, at § 4.01.

87. *See* U.C.C. §§ 8-401(1)(e), 8-406(1)(b), and 8-401(2).

88. 1 CHRISTY, *supra* note 1, at § 285.

89. U.C.C. Foreword to 1978 Official Text & Comments.

90. The Securities Act begins by characterizing itself as "[a]n Act to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof, and for other purposes." Securities Act of 1933, Ch. 38, Preamble, 48 Stat. 74 (1933).

91. Securities Act of 1933, § 5, 15 U.S.C. § 77e (1976) provides as follows:

(a) . . . Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

(b) It shall be unlawful for any person, directly or indirectly—

ties file a disclosure document, called a registration statement, with the Commission prior to any offer[92] of the security for sale,[93] either by the issuer or others; that no written materials, other than the preliminary prospectus contained in the filed registration statement,[94] be used in connection with offering the securities until after the effectiveness[95] of the registration statement; and that the final prospectus, as set forth in the effective registration statement, accompany or precede the delivery of any written sales materials[96] (other than the preliminary prospectus) and the delivery of the certificate evidencing the securities being purchased.[97] Thus, unless the security or the transaction in which it is offered and sold is exempt[98] from these requirements, the issuer or seller of securities must make no oral or written offers or sales prior to the filing by the issuer of a disclosure document with the Commission; must limit any offers made during the period between filing and effectiveness of the registration statement to oral offers or those made through the medium of the preliminary prospectus; must refrain from making any sale until after the effective date of the registration statement; and must deliver to the offeree or buyer a copy of the final prospectus before, or at the time of, the delivery to him of any written sales materials or the securities themselves. Failure of an issuer or seller to comply with these requirements will expose it to liability to its purchaser under Section 12(1) of the Securities

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(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this subchapter, unless such prospectus meets the requirements of section 77 of this title; or

(2) to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 77j of this title.

(c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 77h of this title.

92. "Offer to sell" is defined in Securities Act of 1933, § 2(3), 15 U.S.C. § 77b(3) (1976), as including "every attempt or offer to dispose of . . . a security or interest in a security, for value. . . ."

93. "Sale" is defined in Securities Act of 1933, § 2(3), 15 U.S.C. § 77b(3) (1976), as including "every contract of sale or disposition of a security or interest in a security, for value."

94. In addition to the preliminary prospectus, notices of the type specified in SEC Rule 134, 17 C.F.R. § 230.134 (1981), may also be employed during the so-called waiting period—*i.e.*, the period between the filing and effectiveness of the registration statement. Although § 5 provides that no prospectus (other than the preliminary prospectus) may be used during the waiting period, § 2(10), 15 U.S.C. § 77b(10) (1976), which defines "prospectus," excludes from that definition notices of the type specified in the rule.

95. Under § 8(a) of the Securities Act, 15 U.S.C. § 77h (1976), the registration statement becomes effective on the 20th day after its filing. In practice, issuers agree to delay the effective date until the Commission declares the registration statement effective.

96. Securities Act § 5. *See also id.* § 2(10).

97. Securities Act § 5(b)(2).

98. Statutory exemptions are set forth in Securities Act §§ 3 and 4, 15 U.S.C. §§ 77c, 77d (1976). Those in § 3 are securities exemptions, except §§ 3(a)(9)-3(a)(11), which are regarded by the Commission as transaction exemptions, and those in § 4 are transaction exemptions, the difference being that exempt securities are always exempt from the registration and prospectus delivery requirements, even when resold by their issuees and subsequent holders, while transaction exemptions are available only for specific transactions and each subsequent holder-seller of the security must determine that an exemption is available for his transaction.

Act and to the possibility of an injunctive action by the Commission under Section 20(b) of that Act.[99]

However, as earlier indicated, some securities and transactions are exempt from the registration and prospectus delivery requirements of the Securities Act[100] by virtue of the statutory exemptions set out in Sections 3[101] and 4[102] of the Securities Act or the exemptions created (or in effect created) by the Commission in rules promulgated under Section 2,[103] which is the statute's definitional section, or under Section 3(b),[104] which authorizes the Commission to create exemptions in addition to those set out in the statute, if it finds them to be in the public interest.[105]

Among the statutory transaction exemptions available to issuers is the so-called private offering exemption, set forth in Section 4(2), which provides that the registration and prospectus delivery requirements do not apply to "any transaction by an issuer not involving any public offering."[106] In order to avail itself of this statutory exemption and avoid registration, an issuer must determine, generally speaking, that each and every offeree of the securities in the offering is sufficiently wealthy to bear the economic risk of the investment; is sufficiently experienced and sophisticated in investment matters of this type to be able to fend for himself without need of the protections afforded by the registration and prospectus delivery requirements of the Securi-

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99. Securities Act of 1933, § 12(1), 15 U.S.C. § 77l (1976), provides:

Any person who—

(1) offers or sells a security in violation of section 77e . . . shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

100. After securities have been *publicly* issued and distributed, holders of them who are not "affiliates" of the issuer will generally be free to resell them without compliance with the registration and prospectus delivery requirements, by reason of § 4(1) of the Securities Act. That section exempts from those requirements "transactions by any person other than the issuer, underwriter or dealer." 15 U.S.C. § 77d(1) (1976). "Affiliate" is defined in SEC Rule 405, 17 C.F.R. § 230.405 (a) (1981), as any person who "controls, or is controlled by, or is under common control with, . . ." the issuer. "Control" is defined in the same rule as "the power to direct . . . the management and policies . . . " of the issuer.

101. Securities Act §§ 3(a)(1)–3(a)(11).

102. *Id.* §§ 4(1)–4(6).

103. *Id.* §§ 2(1)-2(14); *see, e.g.*, SEC Rule 144, 17 C.F.R. § 230.144 (1981), which interprets the § 2(11) definiton of "underwriter," thereby bringing conduct of the type set out in the Rule within the ambit of the § 4(1) exemption.

104. Securities Act § 3(b), 15 U.S.C. § 77(c)(b) (1981), provides as follows:

The Commission may from time to time by its rules and regulations, and subject to such terms and conditions as may be prescribed therein, add any class of securities to the securities exempted as provided in this section, if it finds that the enforcement of this subchapter with respect to such securities is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering; but no issue of securities shall be exempted under this subsection where the aggregate amount at which such issue is offered to the public exceeds $5,000,000.

105. Among the exemptions created by the Commission pursuant to Section 3(b) are those set forth in SEC Rules 240 and 242, 17 C.F.R. §§ 230.240 and 230.242 (1981), both of which are intended to facilitate early financings of relatively unseasoned companies and both of which were necessitated by the restrictive interpretations by the courts and the Commission of the statutory private-offering exemption of Section 4(2). *See* text accompanying notes 106–07 *infra*.

106. Securities Act § 4(2), 15 U.S.C. § 77d(2) (1976), provides: "The provisions of section 77e . . . shall not apply to . . . (2) transactions by an issuer not involving any public offering."

ties Act; and has been provided with or has access to sufficient information (of the type usually set forth in a registration statement) to permit the sophisticated, wealthy investor to make an informed investment decision.[107]

In an effort to make these general and subjective requirements somewhat more objective and certain, the Commission promulgated Rule 146,[108] which is an interpretation by the Commission of Section 4(2), but which is not exclusive.[109] Rule 146 includes, among other things, requirements similar to those set out above as to the wealth or sophistication of each offeree,[110] the sophistication (either direct or through a representative) of each purchaser,[111] and the provision of or access to detailed information of the type required by a registration statement.[112] Thus, while an issuer[113] desiring to avoid the registration and prospectus delivery requirements in offering and selling an issue of securities may rely on the statutory exemption as interpreted either by the courts or by the Commission in Rule 146,[114] in either case similar, basic requirements must be met as to the character of the investors and the type of disclosure.

Among the Rule 146 requirements are: that the certificates evidencing the securities sold pursuant to the Rule bear a legend stating that the securities have not been registered under the Securities Act and setting forth any restrictions on transfer or sale of the securities;[115] that stop transfer instructions be given by the issuer to its transfer agent with respect to the securities;[116] and that the issuer obtain from the purchaser of the securities a signed, written agreement that the securities will not be resold without compliance with the Securities Act.[117] These requirements, though expressly set forth in Rule 146, merely reiterate the common practice which has developed in connection with issuance of securities pursuant to the Section 4(2) exemption—to legend the certificates, place stop transfer instructions against them, and obtain an "investment letter" in which the purchaser agrees to such legend and instructions and further agrees not to resell the securities without assuring the

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107. *See* SEC v. Ralston Purina Co., 346 U.S. 119, 125–26 (1953); SEC Rule 146, 17 C.F.R. § 230.146, Preliminary Note 3 (1981). *See generally* JENNINGS & MARSH, *supra* note 14, at 337–45; Marsh, *Who Killed the Private Offering Exemption? A Legal Whodunit*, 71 NW. L. REV. 470 (1976).

108. SEC Rule 146, 17 C.F.R. § 230.146 (1981). In Securities Act Rel. No. 6339, Aug. 7, 1981, the Commission announced that it is considering replacing Rule 146 with new Rule 506, to be part of New Regulation D, the proposed form of which accompanied that Release. While the proposed rule is similar to Rule 146 in content and purpose, there are a number of differences, such as the elimination in the proposed rule of the requirement that the issuer determine the sophistication or wealth of each *offeree*. The requirement of Rule 146 that the issuer determine the qualification of each *purchaser* is retained in the proposed rule, although in somewhat modified form.

109. SEC Rule 146, 17 C.F.R. § 230.146, Preliminary Notes 1 & 4 (1981).

110. *Id.* § (d)(1)(ii).

111. *Id.* §§ (a)(1) and (d)(1)(i).

112. *Id.* § (e).

113. Securities Act § 4(2), of which SEC Rule 146 is an interpretation, is only available to issuers, not for resales by security holders. Rule 146 is therefore only available to issuers. *See* SEC Rule 146, 17 C.F.R. § 230.146, Preliminary Note 6 (1981).

114. SEC Rule 146, 17 C.F.R. § 230.146, Preliminary Note 1 (1981).

115. *Id.* § (h)(2).

116. *Id.* § (h)(3).

117. *Id.* § (h)(4).

issuer, through a legal opinion or no-action letter, that the resale will not be in violation of the Securities Act's registration and prospectus delivery requirements.[118]

This practice did not develop out of a gratuitous or altruistic desire on the part of issuers to help the Commission prevent future securities law violations by the holders of their securities. It developed because issuers and their counsel recognized that the issuer itself could lose the private offering exemption,[119] on which it had relied to avoid registering the securities that it issued and sold, if purchasers of these securities were to publicly resell them without compliance with the Securities Act registration and prospectus delivery requirements or with the terms of an exemption therefrom.[120]

If such exemption were lost by the issuer, it would then be exposed to liability under Section 12(1)[121] to all who purchased securities from it in that "offering."[122] There would also be exposure to the possibility of an injunctive action by the Commission under Section 20(b) since the registration and prospectus delivery requirements of Section 5 were not satisfied prior to the offers and sales to the purchasers and since the private offering exemption, previously thought to be available, had been eliminated by the later conduct of a purchaser.

That a purchaser's conduct, subsequent to his purchase of securities from the issuer, can destroy the issuer's private offering exemption results from the interplay of that exemption[123] and the definition of the term "underwriter" as set forth in the Securities Act.[124] In order for a transaction by an issuer to be exempt under Section 4(2) it must not involve *any* public offering, which means that all of the offerees and purchasers must be wealthy, sophisticated and informed.[125] However, an offering can be made not only by the issuer, but also on its behalf by underwriters, a term which includes any person who takes securities from the issuer or from a controlling person of the issuer with a view to distributing them, or who participates in the distribution of them.[126] Thus, if one of the sophisticated, wealthy participants in a pre-

118. *See* U.C.C. § 8-204, Official Comment 5; N.Y. U.C.C., Practice Commentary (McKinney 1964); JENNINGS & MARSH, *supra* note 14, at 394; Folladori, *supra* note 1, at 394–95; Israels, *Stop-Transfer Procedures and the Securities Act of 1933—Addendum to Uniform Commercial Code—Article 8*, 17 RUTGERS L. REV. 158, 163–64 (1962).

119. Securities Act § 4(2), 15 U.S.C. § 77d(2) (1976). *See* text accompanying notes 123–27 *infra*.

120. *See* Securities Act Release No. 3825 [1957–61 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 76, 539 (1957); JENNINGS & MARSH, *supra* note 14, at 394; Israels, *Stop Transfer Procedures and the Securities Act of 1933—Addendum to Uniform Commercial Code—Article 8*, 17 RUTGERS L. REV. 158, 161–62 (1962).

121. Securities Act § 12(1). *See* note 99 *supra*, in which this section is set out.

122. For certain factors which should be considered in determining when various transactions will be regarded as part of an "integrated" offering, *see* Securities Act Release No. 4552, 27 Fed. Reg. 11,316 (1962). *See also* SEC Rule 146, 17 C.F.R. § 230.146, Preliminary Note 3 (1981); SEC Rule 147, 17 C.F.R. § 230.147, Preliminary Note 3 (1981); SEC Rule 240, 17 C.F.R. § 230.240, Preliminary Note 6 (1981); SEC Rule 242, 17 C.F.R. § 230.242, Preliminary Note 6 (1981).

123. Securities Act § 4(2), 15 U.S.C. § 77d(2) (1976).

124. *Id.* § 2(11), 15 U.S.C. § 77b(11) (1976).

125. *See* text accompanying note 107 *supra*.

126. Securities Act § 2(11), 15 U.S.C. § 77b(11) (1976).

sumed private placement under Section 4(2) or Rule 146 buys those securities with a view to reselling them to the public,[127] that person is an underwriter, or conduit, through whom the securities will flow to others, presumably unsophisticated, nonwealthy "public" investors. Since the securities wind up in the hands of the public through the conduct of this underwriter, the private offering exemption is no longer available.

In an effort to prevent purchasers in private placements from becoming underwriters, and thereby subjecting their issuers to liability in the manner described above, the practice as to legends, stop transfer instructions, and "investment letter" agreements, all of which are now required when reliance is to be placed on Rule 146, grew up under Section 4(2).[128] While the employment of these measures cannot guarantee that a purchaser will not become an underwriter of the securities, it can make such a result less likely, since brokers and dealers, through whom most public resales of securities are made, will not deal in legended securities,[129] at least not without adequate assurances as to compliance with the securities laws,[130] and since the purchaser-underwriter knows that, under his investment letter agreement, he will be liable to the issuer for any damages suffered by it as a result of his failure to abide by the terms of the investment letter.[131] Therefore, all certificates evidencing securities placed in reliance on Rule 146 must contain,[132] and presumably the vast majority of those placed in reliance on Section 4(2) "outside" of Rule 146 do contain,[133] legends (supported by investment letter agreements and stop transfer instructions to the transfer agent) restricting the transfer of the securities by their holder until he has satisfied the issuer, typically through an opinion of counsel or no-action letter, that the resale will not violate the registration and prospectus delivery requirements of the Securities Act.[134]

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127. Private resales to wealthy, sophisticated and informed persons are possible, without registration, pursuant to the so-called "Section 4 (1½) exemption." *See The Section "4 (1-1/2)" Phenomenon: Private Resales of "Restricted" Securities*, 34 BUS. LAW. 1961 (1979).

128. *See* JENNINGS & MARSH, *supra* note 14, at 394.

129. *See* Israels, *Stop-Transfer Procedures and the Securities Act of 1933—Addendum to Uniform Commercial Code—Article 8*, 17 RUTGERS L. REV. 158, 164 (1962). Member firms of the NASD cannot make "good delivery" with legended, restricted shares, NASD Circular, [1972 Transfer Binder] FED. SEC. LAW REP. (CCH) ¶ 78,809 (1972), and therefore before an NASD member will act as selling broker in a public resale of restricted securities he will require that the certificates be reissued in clean form or that adequate assurances be given that clean certificates will be promptly issued by the transfer agent. N. WOLFSON, R. PHILLIPS & T. RUSSO, REGULATION OF BROKERS, DEALERS AND SECURITIES MARKETS § 10.06 (1977); *Developments in Private Placements, Distribution of Restricted Securities; Rule 144*, 28 BUS. LAW. 483, 498–500 (1973).

130. *See* note 129 *supra*.

131. In addition, the selling security holder, as an underwriter in the unregistered distribution, will be liable to his buyer for damages or for rescission under Section 12(1) of the Securities Act. *See* note 99 *supra*.

132. *See* SEC Rule 146(h)(2), 17 C.F.R. § 230.146(h)(2) (1981).

133. Although there is no requirement in the Securities Act that privately placed shares bear any legend, *see* Edina St. Bank v. Mr. Steak, Inc., 487 F.2d 640, 644 (10th Cir.), *cert. denied*, 419 U.S. 883 (1974); DeWitt v. American Stock Transfer Co., 433 F. Supp. 994, 1002, *modified*, 440 F. Supp. 1084 (S.D.N.Y. 1977), the Commission, in addition to including a legend requirement in Rule 146, has stated that it regards the presence or absence of appropriate legends or stop transfer instructions as a factor in determining the availability of the Section 4(2) exemption. Securities Act Release No. 5121, [1970–71 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 77,943 (1970). However, for a variety of reasons some securities sold in private transactions under Section 4(2), outside of Rule 146, may not bear such legends. *See* Folk, *supra* note 68, at 1404 & n.91.

134. *See* JENNINGS & MARSH, *supra* note 14, at 394.

For a resale of securities acquired in a private placement ("restricted securities") to comply with the Securities Act, the registration requirements must be complied with by the issuer at the time of the securities' offer and sale by their holder to the new purchaser; or the securities must be resold by their holder to another sophisticated, wealthy and well-informed investor, rather than distributed to the public generally;[135] or they must be sold publicly in such circumstances that the resale does not indicate that the seller was an "underwriter" with respect to the securities when he acquired them.[136]

In 1972 the Commission adopted Rule 144[137] for a primary purpose of setting forth the circumstances in which restricted securities may be resold by their holder to the public without rendering such holder an underwriter.[138] While that rule is not the exclusive way in which restricted securities must be publicly resold by their holders,[139] it is certainly the principal way in which public resales of such securities are made, since the Commission has indicated in the release accompanying the adoption of Rule 144[140] that any person who publicly sells restricted securities "outside" of Rule 144 will bear a heavy burden of proof in attempting to establish that he is not an underwriter.

Therefore, most holders of restricted securities who choose to resell publicly without registration do so under Rule 144 for two reasons: first, the holder wants to be certain that he will be entitled to the exemption from the registration and prospectus delivery requirements which is provided by Section 4(1) for "transactions by any person other than an issuer, underwriter, or dealer";[141] second, the holder wants to make clear to his lawyer that his proposed public resale will not render him an underwriter so that he will, therefore, be in a position to get whatever legal opinion or no-action letter is required as a condition to the issuer's removal of the legend and stop transfer instructions. This is important because the public sale of legended shares through the organized securities market will be difficult, if not impossible.[142]

Not only does Rule 144 pertain to the public resale of restricted securities by holders who might be rendered underwriters by their noncompliance with it; it also pertains to public resales by another class of holders whose noncompliance with the requirements of the rule *will* render them underwriters—

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135. *See The Section "4(1-1/2)" Phenomenon: Private Resales of "Restricted" Securities*, 34 BUS. LAW. 1961 (1979).

136. Securities Act § 4(1), 15 U.S.C. § 77d(1) (1976), provides a transaction exemption from the registration requirements of § 5 for transactions by a person other than an issuer, underwriter, or dealer. Most sellers of restricted securities are quite clearly neither "issuers," within the meaning of Securities Act § 2(4), nor "dealers," within the meaning of Securities Act § 2(12). Thus, the availability of the exemption usually turns on the question of whether the seller is an "underwriter," within the meaning of Securities Act § 2(11).

137. SEC Rule 144, 17 C.F.R. § 230.144 (1981).

138. Securities Act Release No. 5223, [1971–72 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 78,487 (1972); SEC Rule 144, 17 C.F.R. § 230.144, Preliminary Note (1981).

139. Securities Act Release No. 5223, [1971–72 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 78,487 (1972).

140. *Id.*

141. Securities Act § 4.1, 15 U.S.C. § 77d(1) (1976).

142. *See* note 129 *supra* and accompanying text.

control persons.[143] Because the term "underwriter," as defined in the Securities Act,[144] includes any person who has purchased securities from their issuer or a control person of the issuer with a view to or in connection with their distribution, a control person of the issuer could never publicly sell securities without registration, but for Rule 144. Rule 144 provides that a control person can publicly resell securities but only in compliance with all of the applicable provisions of the rule. This requirement applies to all securities of the control person, whether acquired in private transactions, in public offerings, or in the secondary trading markets.[145]

Again, failure of a control person of the issuer to comply with the Rule 144 requirements on public resales will render the control person an underwriter and expose the issuer to liability.[146] However, unlike the situation with respect to restricted securities, where legends, stop transfer instructions and the like are usually imposed to provide some protection to the issuer,[147] it is common in the case of "control securities" for the certificates to remain unlegended,[148] because the control person who acquires them may do so in any number of ways (including but in no way limited to direct purchase from the issuer). Stop transfer instructions may, however, be imposed by the issuer against the account of the control person.[149]

In summary, then, if an issuer issues securities without registration in reliance on the private placement exemption, it is likely that the certificates evidencing those securities will bear restrictive legends supported by an investment letter and stop transfer instructions, since it is possible that public resale of the securities will cause both their holder and the issuer to violate the registration and prospectus delivery requirement of the Securities Act. In addition, if securities of an issuer are held by its control persons, public resale of those "control" securities may cause both the issuer and the control person to violate the Securities Act. But control securities, as a practical matter, are often free of legends setting forth any restrictions on their transfer, although sometimes stop transfer instructions are entered against them with the transfer agent by the issuer. It is with respect to the sale, transfer, and recording of the transfer of restricted and control securities that cases arise dealing with the supposed conflict between Article 8 of the U.C.C. and the Securities Act.[150]

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143. SEC Rule 144, 17 C.F.R. § 230.144 (1981), provides the only means by which "affiliates" of the issuer can sell the securities of the issuer. Securities Act Release No. 5223, [1971–72 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 77,487 (1972). An "affiliate," as defined in the Rule and in SEC Rule 405, 17 C.F.R. § 230.405(a) (1981), is any person controlling, controlled by, or under common control with, the issuer.

144. Securities Act § 2(11), 15 U.S.C. § 77b(11) (1976).

145. SEC Rule 144(e)(1), 17 C.F.R. § 230.144(e)(1) (1981); Securities Act Release No. 5223, [1971–72 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 77, 487 (1972).

146. *See* text accompanying note 127 *supra*.

147. *See* text accompanying notes 116–22 *supra*.

148. *See* U.C.C. § 8-204, Official Comment 5.

149. *Id.*

150. Folladori, *supra* note 1, at 395; Johnson, *supra* note 1, at 311–12. *See also* Bell and Arky, *supra* note 7, at 1658–59.

However, before turning to that supposed conflict, the concept of aider and abettor liability under the Securities Act must be noted. As earlier indicated, Section 12(1)[151] imposes civil liability on any person who offers or sells a security in violation of the registration and prospectus delivery requirements of Section 5 of the Securities Act, and Section 20(b) allows the Commission to seek injunctive relief against such persons. Even though not expressly provided for in the Securities Act, it may, however, be possible for persons other than the offeror-seller specified in the Act to be subjected to liability for the violations of its registration provisions under the doctrine of aiding and abetting.[152] This concept, which originally developed in the federal securities area in the context of Rule 10b-5 cases,[153] has since been applied to violations of the Securities Act as well.[154]

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151. Securities Act § 12(1), which is quoted at note 99 *supra*.

152. *See, e.g.*, S.E.C. v. International Chem. Dev. Corp., 459 F.2d 20, 27 (10th Cir. 1972); S.E.C. v. North American Research & Dev. Corp., 424 F.2d 63, 81–82 (2d Cir. 1970); Stern v. American Bancshares Corp., 429 F. Supp. 818, 824–25 (E.D. Wis. 1977); Sandusky Land, Ltd. v. Uniplan Groups, Inc., 400 F. Supp. 440, 444 (N.D. Ohio 1975); *In re* Ceasars Palace Sec. Litigation, 360 F. Supp. 366, 378–80 (S.D.N.Y. 1973); Johnson, *supra* note 1, at 312; Weiss, *supra* note 6, at 563; Bell and Arky, *supra* note 7, at 1661. *See also* Little v. Valley Nat'l Bank of Ariz., 650 F.2d 218, 222–23 (9th Cir. 1981).

However, a number of recent cases have held, contrary to *Stern, Sandusky* and *Ceasars Palace*, cited above, that aiders and abettors of Securities Act violations will not (or, at least, not necessarily) be liable in civil damages (or for rescission) under §§ 11 or 12 of that Act, since those sections impose civil liability on specified persons, not including aiders and abettors. Stokes v. Lokken, 644 F.2d 779, 784–85 (8th Cir. 1981); Pharo v. Smith, 621 F.2d 656, 669 (5th Cir.), *rehearing* 625 F.2d 1226 (1980); Hagert v. Glickman, 520 F. Supp. 1028 (D. Minn. 1981); Benoay v. Decker, 517 F. Supp. 490, 494 (E.D. Mich. 1981); *In re* Equity Funding Corp. of America, Securities Litigation, 416 F. Supp. 161, 181 (C.D. Cal. 1976).

These cases do not, however, hold that the aider and abettor concept does not apply to the Securities Act or that a person can never be liable for aiding and abetting a Securities Act violation; they hold, rather, that such a person will not be subject to the sanctions or remedies provided by §§ 11 and 12 of that Act. Indeed, *Pharo* and *Hagert* seem to expressly recognize that a person may aid and abet a violation of the Securities Act. In the *Pharo* case, the court stated at page 669 that:

> A participant in a sale of stock that transgresses section 12 could be an aider and abettor, as defined at common law. . . . The panel in *Hill York* was faced with fashioning a test for determining which participants, out of the universe of possible participants, in a section 12 sale should be subjected to liability [under that section] as sellers.

The court in *Hagert* at page 1034 stated that:

> Sections 11 and 12 (2) are express liability provisions, as contrasted to Sections 17(a) and [*sic*] the 1933 Act and Section 10(b) of the 1934 Act which define violations or make certain acts unlawful. The concept of aiding and abetting, with its origin in the criminal law, is a more proper adjunct to the violation sections. . . . This reasoning applies with equal force to § 12(2), notwithstanding the expansive view of privity generally taken with regard to that provision.

Thus, even if the views expressed in these recent cases are accepted over the contrary views set out in *Caesars Palace, Sandusky* and *Stern*, a person who aids and abets a distribution of unregistered securities can still violate § 5 of the Securities Act, just as a person who aids and abets the making of a false statement (in a prospectus or otherwise) in connection with a sale of securities can violate § 17(a) of that statute. However, if the views expressed in the recent cases are accepted, neither such person would necessarily have any civil liability for his conduct under § 12(1), § 11 or § 12(2), although such person presumably could be enjoined from such conduct by the Securities and Exchange Commission under § 20(b) of the Securities Act. Of course, it remains to be seen whether the views expressed in the recent cases or those expressed in *Stern, Sandusky* and *Caesars Palace* will prevail as to the application of §§ 12 and 11 to aiders and abettors.

For an excellent discussion of the aider and abettor concept, *see* Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, In Pari Delicto, Indemnification, and Contribution*, 120 U. PA. L. REV. 597 (1972).

153. *See* JENNINGS & MARSH, *supra* note 14, at 1096.

154. *Id.* at 1096–1100. *See also* note 152 *supra*.

While the elements necessary to constitute a person an aider or abettor of a securities law violation have been stated differently by different courts,[155] it is reasonably clear that before a person will be characterized as an aider and abettor of a securities law violation, it must be shown that another person has perpetrated such a violation and that the alleged aider and abettor, while at least generally aware of the impropriety of the other person's conduct, provided substantial assistance in perpetrating the violation.[156]

Among the factors sometimes considered in determining whether the assistance so provided was "substantial" are those enumerated in the Comment to Section 876 of the Restatement (Second) of Torts.[157] These include (1) the amount of assistance given by the alleged aider and abettor to the violator; (2) the relation of the alleged aider and abettor to the violator; (3) the state of mind of the alleged aider and abettor; and (4) the presence or absence of the alleged aider and abettor at the time of the violation. These factors will be discussed in Part III *infra*.

Thus, because of the existence of the doctrine of aiding and abetting, it is conceivable that a party (such as a transfer agent) who neither offers nor sells securities could be held liable for violating Section 5 of the Securities Act.[158] It is this possibility which has led courts and commentators to the conclusion that the transfer agent's duties under Article 8 and under the Securities Act will sometimes conflict, since compliance by a transfer agent with its duty to record transfers under Article 8 may render it an aider and abettor in the Securities Act violation of the transferor or issuer.[159] In such a situation, it can be argued that the transfer agent's duties under Article 8 must yield to its responsibilities under the Securities Act,[160] due to the supremacy clause of the Constitution,[161] and the transfer agent must refuse to record the requested transfer even if it has a duty to do so under Article 8 and even if it has been instructed to do so by its principal, the issuer.

Commentators continue to make this argument even though there is no case which holds a transfer agent liable as an aider and abettor in a securities law violation simply for performing its transfer agency functions[162] (although there are cases which recognize the possibility of aider and abettor liability for

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155. For example, *compare* SEC v. Coffey, 493 F.2d 1304 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975), *with* Landy v. F.D.I.C., 486 F.2d 139 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974). *See also* Woodward v. Metro Bank of Dallas, 522 F.2d 84 (5th Cir. 1975); JENNINGS & MARSH, *supra* note 14, at 1096–1100.

156. *See* note 155 *supra*.

157. RESTATEMENT (SECOND) OF TORTS § 876 (1976); *see* Landy, v. F.D.I.C., 486 F.2d 139, 162–63 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974). *See also* JENNINGS & MARSH, *supra* note 14, at 1098–99.

158. *See* note 152 *supra*. There is no case holding a transfer agent, who functioned solely as such, liable as an aider and abettor of violations of Securities Act § 5. *See* text accompanying notes 259–64 *infra*.

159. *See* Bell and Arky, *supra* note 7, at 1661; Hoblin and Kelly, *supra* note 7, at 587; Johnson, *supra* note 1, at 312; Weiss, *supra* note 6, at 563.

160. Charter Oak Bank & Trust Co. v. Registrar & Transfer Co., Inc., 141 N.J. Super. 425, 434, 358 A.2d 505, 510 (1976); Bell and Arky, *supra* note 7, at 1660–61; Weiss, *supra* note 6, at 563.

161. U.S. CONST., art. VI, § 2.

162. In the cases in which transfer agents or their officers have been held liable as aiders or abettors the transfer agent or officer acted in other capacities as well, and it was its function in these roles which subjected it to liability. *See* text accompanying notes 259–64 *infra*.

transfer agents)[163] and even though there is no case holding that a transfer agent *must* refuse to record a transfer where the transfer appears to have been in violation of the federal securities laws (although there are cases which hold that the transfer agent *may* refuse in such circumstances).[164] Therefore, the next part of this Article will examine certain situations in which a transfer agent is called upon to act to see whether there truly is any conflict in its duties under the U.C.C. and under the Securities Act in those situations and, further, to see if any potential conflict between those statutes can be harmonized through recognition of the transfer agent's duties to its principal under the law of agency.

II. TRANSFER AGENT'S DUTIES—CONFLICTING OR COMPATIBLE?

In the following discussion, it is assumed: that a transfer agency relationship has been established either by agreement between the transfer agent and the issuer or by resolution of the issuer's board of directors; that the transfer agent has been instructed and has agreed to process the recordation of transfers in accordance with its normal procedures, except as otherwise instructed by the issuer; that the issuer will place legends or "stop transfer" instructions against an account when it wishes to cause the recordation of transfers of securities in that account to be processed other than in the normal course; that if requested to record a transfer of legended certificates or certificates in an account as to which stop transfer instructions have been entered, the transfer agent will request instructions from the issuer as to how to proceed; and that "restricted securities" (those issued in private placements without registration under the Securities Act) will ordinarily bear a legend indicating the restrictions on their transferability, but that "control securities" will usually not be legended. All of these assumptions are believed to be consistent with recognized, accepted practices in the transfer agency industry.

A. *Imposition and Removal of Legends and Stop Transfer Instructions*

One of the functions of the transfer agent is to place legends reflecting restrictions imposed by the issuer on the transferability of the securities on certain certificates,[165] which is usually done at the time that they are issued.[166] Another function is to place and maintain stop transfer instructions against certain accounts (including but not limited to the accounts of persons who hold legended securities).[167] As previously discussed,[168] the possibility of fu-

163. *See, e.g.*, Melville v. Wantschek, 403 F. Supp. 439, 445–46 (E.D.N.Y. 1975); Charter Oak Bank & Trust Co. v. Registrar & Transfer Co., Inc., 141 N.J. Super. 425, 358 A.2d 505 (1976). *See also* Doliner v. Eastern Can Co., 62 Misc. 2d 555, 559, 309 N.Y.S.2d 249, 253 (Sup. Ct. 1965).

164. *See* text accompanying notes 304–22 *infra*.

165. Folladori, *supra* note 1, at 388; Johnson, *supra* note 1, at 311.

166. Israels, *Stop-Transfer Procedures and the Securities Act of 1933—Addendum to Uniform Commercial Code—Article 8*, 17 RUTGERS L. REV. 158, 164 (1962); Weiss, *supra* note 6, at 558.

167. Folladori, *supra* note 1, at 388; Johnson, *supra* note 1, at 311; Weiss, *supra* note 6, at 558.

168. *See* text accompanying notes 123–28 *supra*.

ture Securities Act violations by the holder is one of the concerns which gives rise to the use of legends and stop transfer instructions.

However, not every security holder is a potential future violator of the registration and prospectus delivery requirements[169] and therefore, not every outstanding certificate needs to be, or can reasonably be,[170] legended and subjected to stop transfer instructions. The securities which are to be so treated are usually those issued in reliance on the Section 4(2) private offering exemption, whether within or without Rule 146, and those held by control persons of the issuer.[171] Thus, before legends or stop transfer instructions are imposed, legal determinations have to be made as to which securities give rise to a need for such protections.

Since the transfer agent is in no position to determine whether all of the requirements of Section 4(2) or Rule 146 have been met or to determine who is a "control" of the issuer,[172] these determinations are made by the issuer, who is in the best position to make them and who then instructs the transfer agent as to the legends and stop transfers which are to be imposed.[173] When the transfer agent thereafter imposes these legends and stop transfer instructions in accordance with its issuer's instructions, it is complying with its duty under the law of agency to follow its principal's instructions and its duty under Section 8-406 of the U.C.C. to act in good faith with respect to the issuer.

Just as the transfer agent is in no position to determine when legends or stop transfer instructions should be imposed, it is also in no position to determine when they should be removed or when the conditions to the restrictions on transfer have been satisfied.[174] Such a determination might require, for example, accumulation of factual data and the making of legal judgments as to compliance by the holder and the issuer with the various requirements of Rule 144,[175] or as to the termination or continuation of the holder's control relationship with the issuer.[176] Therefore, transfer agents turn to their issuers for instructions when confronted with requests by holders that restrictions on transfer be removed, ignored, waived or deemed inapplicable because of the satisfaction of the specified conditions.[177]

It is appropriate that transfer agents turn to and follow their issuer's instructions in these circumstances, not only because the issuer is in the best position to determine whether the restriction continues to be viable, but also because it is the issuer who imposed the restriction in the first place and for whose protection the restriction was imposed.[178] This practice is also con-

169. *See* note 100 *supra*.

170. Only reasonable restrictions on the alienability of shares can be imposed. 1 CHRISTY, *supra* note 1, at §§ 36–37.

171. *See* Folladori, *supra* note 1, at 394; Johnson, *supra* note 1, at 311–12; Weiss, *supra* note 6, at 557.

172. *See* text accompanying notes 328–36 *infra*.

173. *Id.*

174. *See* 1 CHRISTY, *supra* note 1, at § 51.

175. *See* text accompanying notes 328–36 *infra*.

176. *Id.*

177. 1 CHRISTY, *supra* note 1, at § 51.

178. *See* text accompanying notes 119–27 *supra*.

sistent with the requirements of the law of agency—that agents seek instructions from their principals rather than draw their own inferences.

Thus, while one of the functions of the transfer agent is to impose, maintain and remove Securities Act legends or stop transfer instructions, for the reasons stated above it should do so only on the express instructions of its issuer. Such conduct should satisfy the transfer agent's responsibilities to its principal, both under the law of agency and under the U.C.C., without violating any of its responsibilities under the Securities Act. This conclusion is supported in practice by the fact that it has never been contended in a reported case that a transfer agent will aid and abet a Securities Act violation by failing to impose, on its own and without instructions from its issuer, restrictive legends or stop transfer instructions on control securities or restricted securities.[179] Furthermore, there are no judicial holdings to support the notion of aider and abettor liability for a transfer agent which follows its issuer's instruction in removing restrictive legends or stop transfer instructions.[180]

B. *Request for Recordation of Transfer of Unlegended "Control" or "Restricted" Securities*

As previously indicated, the offer or sale to the public of control or restricted securities can result in a violation by the seller and the issuer of Section 5 of the Securities Act, unless they have met the conditions of Rule 144.[181] In an effort to prevent such transfers from taking place, it is customary,[182] but not universal,[183] to legend restricted securities, but it is not customary to legend "control" securities.[184] Thus, it is possible for restricted securities or control securities to be outstanding without any indication on their face that potential securities law problems are lurking which their public resale may present.[185]

If control or restricted securities are outstanding in "clean," unlegended form, it will be possible for their holder to resell them publicly and to complete the sale and transfer of the securities before the transfer agent or issuer becomes involved in the transaction.[186] For example, if the clean certificates are held in street name[187] or in the name of an individual or partnership, the beneficial holder of the securities will be able to sell them, even on the or-

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179. *But see* Bell and Arky, *supra* note 7, at 1661; Weiss, *supra* note 6, at 563.

180. *See* text accompanying notes 259–63 *infra*. *See also* Wassel v. Eglowski, 399 F. Supp. 1330, 1367–68 (D. Md. 1975), *aff'd per curiam*, 542 F.2d 1235 (4th Cir. 1976).

181. *See* text accompanying notes 123–27 *supra*.

182. *See* text accompanying notes 128–30 *supra*.

183. *See* text accompanying note 128 *supra*.

184. *See* text accompanying notes 148–49 *supra*.

185. *See, e.g.*, Edina State Bank v. Mr. Steak, Inc., 487 F.2d 640, 642 (10th Cir.), *cert. denied*, 419 U.S. 883 (1974). *See also* U.C.C. § 8-204, Official Comment 5; Bell and Arky, *supra* note 7, at 1661; Folk, *supra* note 68, at 1404; Weiss, *supra* note 6, at 563.

186. Hoblin and Kelly, *supra* note 7, at 583 & n.10.

187. Securities held in "street name" are registered in the name of beneficial owner's broker or its nominee or clearing agency. For a discussion of "street name" registration and its purpose and benefits, *see* Hoblin and Kelly, *supra* note 7, at 582–83.

ganized securities markets,[188] simply by endorsing them[189] and making delivery to the buyer or his designee,[190] or by instructing the record holder to make the appropriate endorsement and delivery. Even if the clean certificates are held of record by a corporation or a trust, for example, their owner can still sell and transfer them in a private transaction, rather than on the organized securities markets, without involving the transfer agent or issuer prior to the accomplishment of the sale. Such a sale and transfer will be completed at the point[191] when the endorsed certificates are delivered to the buyer or his broker; and at this point in time, without any involvement of the transfer agent whatever, the Securities Act violation will have occurred.[192]

Following such a sale and upon the request of the purchaser, the transfer agent and issuer will most likely have an obligation under Article 8[193] to record the transfer, even though the transfer violated the Securities Act, since the certificate was properly endorsed by the seller;[194] the absence of a legend (and, presumably, stop transfer instructions) probably means that the transfer agent and issuer have no duty to inquire into adverse securities law claims;[195] and the absence of such a legend probably means that the purchaser is a BFP.[196] Thus, even if the completed transfer is not regarded as rightful, since it violated Section 5 of the Securities Act, the transfer agent and issuer are under a duty to record the transfer, because even a wrongful transfer must be recorded when the purchaser is a BFP,[197] assuming that all of the other requirements of Section 8-401 are met.

But if the transfer agent fulfills its duty by recording the transfer, will it aid and abet a Securities Act violation? This question should be answered in the negative for a number of reasons.

If the certificate which has been presented for transfer is not legended and is subject to no stop transfer instructions, the transfer agent may be unaware of the securities law violation and of the impropriety of the seller's conduct. If this is so, the transfer agent will not have aided and

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> [T]he rules and customs of the organized securities market effectively limit "good delivery" to securities in "street name," or in the name of a living individual, or a partnership, which are in each case duly endorsed with signature guaranteed. Thus, where securities stand registered in any other form, they will invariably be tendered for registration of transfer out of that name prior to delivery to the buyer.

Israels, *Stop-Transfer Procedures and the Securities Act of 1933—Addendum to Uniform Commercial Code—Article 8*, 17 RUTGERS L. REV. 158, 165 (1962) (footnote omitted).

189. U.C.C. § 8-401(1)(a). In addition to the endorsement, a signature guarantee will also be required. However, since the certificates are "clean" and no stop transfer instructions have been given, no duty of inquiry with respect to an adverse claim arises under U.C.C. § 8-401(1)(c).

190. U.C.C. § 8-313(1)(a).

191. Hoblin and Kelly, *supra* note 7, at 583 n.10.

192. *See* text accompanying notes 93–99 *supra*.

193. U.C.C. §§ 8-401 and 8-406. *See* text accompanying notes 58–79 *supra*.

194. U.C.C. § 8-401(1)(a). For the purposes of this discussion it is assumed that an appropriate signature guarantee has been procured, in satisfaction of U.C.C. § 8-401(1)(b), and that any applicable law relating to tax collection matters has been complied with, as required by U.C.C. § 8-401(1)(d).

195. *See* text accompanying notes 69–77 *supra*.

196. U.C.C. §§ 8-302(1) and 8-401(1)(d). *See* text accompanying notes 79–84 *supra*.

197. *See* text accompanying notes 79–84 *supra*.

abetted the violation, since one of the elements necessary to support the aider and abettor characterization is at least a general awareness of the impropriety of the conduct of the principal violator.[198]

Suppose, however, that prior to recording the transfer the transfer agent is aware that the transferor may be a "control" person or that the unlegended securities were in fact issued in an unregistered private placement. Such awareness could come, for example, from the transfer agent's familiarity with the issuer's management structure and personnel or from its familiarity with the issuer's stock ownership structure and history, as well as from stop transfer instructions from the issuer. However, this awareness would not necessarily mean that the transfer agent was aware of the impropriety of the seller's conduct, since even control persons and holders of restricted securities can publicly sell their securities if they comply with Rule 144[199] or privately resell them,[200] and it may be that the transfer agent has assumed that the transfer is a proper rather than an improper one. Such an assumption would seem to be plausible, especially when the transfer agent has been told by the issuer (its principal, to whom it owes a duty to follow directions[201] and to whose detriment Securities Act violations by the seller will redound)[202] to process transfers unless the issuer tells it to do otherwise, something it has not done.

But now suppose that the transfer agent is aware that the unlegended securities presented for recordation of transfer are "control" or "restricted" securities and that their sale was in violation of the Securities Act. If the transfer agent records the transfer in these circumstances and in fulfillment of its duty to the innocent purchaser under Section 8-406, it should not be regarded as an aider and abettor in the Securities Act violation, even though it was aware of the seller's improper conduct at the time it recorded the transfer. Since the Securities Act violation occurred at the time of the sale,[203] the subsequent action of the transfer agent in recording the transfer could not have substantially assisted in bringing about that violation. Thus, the "substantial assistance" element[204] is absent and the aider and abettor characterization should not result.[205]

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198. *See* text accompanying notes 151–59 *supra*.

199. *See* text accompanying notes 138–46 *supra*.

200. *See* note 135 *supra* and accompanying text.

201. *See* text accompanying notes 43–49 *supra*.

202. *See* text accompanying notes 119–27 *supra*.

203. Securities Act §§ 2(3) and 5, 15 U.S.C. §§ 77 b(3), 77e (1976); Hoblin and Kelly, *supra* note 7, at 853 & n.10. *See also* Kanton v. United States Plastics, Inc., 248 F. Supp. 353, 358 (D.N.J. 1965); Riskin v. National Computer Analysts, Inc., 62 Misc. 2d 605, 308 N.Y.S.2d 985 (Sup. Ct. 1970), *modified*, 37 A.D.2d 952, 326 N.Y.S.2d 419 (1971). *But see* Weiss, *supra* note 6, at 556.

204. *See* text accompanying notes 156–57 *supra*.

205. While it is true that the refusal by the transfer agent to record a transfer may result in the rescission of the prior, unlawful sale (*see* U.C.C. §§ 8-306 and 8-316 and Israels, *Stop-Transfer Procedures and the Securities Act of 1933—Addendum to Uniform Commercial Code—Article 8*, 17 RUTGERS L. REV. 158, 165–66 (1962)), rescission does not undo the prior violation of the Securities Act. Thus, even though the transfer agent may be in a position to force rescission of the unlawful sale on the buyer, by refusing to record the transfer, it is not here in a position to assist in the "doing or the undoing" of the Securities Act violation. *Cf.* CAL. CORP. CODE § 25507(b) (West Supp. 1981). For further discussion of the *buyer's* right to rescission, *see* text accompanying notes 211–12 *infra*.

Furthermore, as noted earlier,[206] whether or not an alleged aider and abettor has rendered substantial assistance to the principal violator may depend, in part, on the state of mind of the alleged aider and abettor.[207] If the alleged aider and abettor was motivated to act as it did by reasons other than a desire to further the securities law violation, it will not have rendered "substantial assistance" to the principal violator.[208] Such a motivating factor is present, of course, where a transfer agent records a prior transfer of unlegended certificates, since the buyer of these securities is most likely to be a BFP[209] and failure to record the transfer is likely, therefore, to expose the transfer agent to liability under Sections 8-401 and 8-406 of the U.C.C. In addition, in recording the transfer, the transfer agent is fulfilling its duty to follow the issuer's instructions.[210]

The conclusion that the transfer agent ought to be able to record the transfer of previously sold, unlegended securities, without fear of Securities Act liability, makes considerable sense. The innocent purchaser of these securities became the owner of them at the time of delivery[211] and thereafter they are *his* securities. While Section 12(1) of the Securities Act gives such an innocent purchaser the right to rescind his purchase transaction,[212] nothing in the Securities Act gives the *seller* any right of rescission or gives the issuer or its transfer agent any right to force rescission of the sale upon the buyer. Yet, if the transfer agent is required or permitted to refuse to record the prior transfer of unlegended securities because of its fear that aider and abettor liability will arise, the buyer will have had rescission of the transaction forced upon him.

Thus, in summary, where a sale of unlegended "control" or "restricted" shares takes place, followed by a request for recordation of the transfer: (1) the transfer agent will normally be under a duty to the purchaser to record the transfer and (2) the fulfillment of that duty should not conflict with the Securities Act, since the transfer agent is not, in recording the transfer, in a position to aid and abet the Securities Act violation, which occurred at time of sale. Thus, in this situation, there should be no conflict between these duties. Nor is there any conflict in this situation between these duties and the duty of the transfer agent to its principal under the law of agency, since it has been assumed here that the principal's continuing instructions to the transfer agent are to record transfers routinely until otherwise instructed by the issuer.

But now suppose that the issuer places with the transfer agent stop transfer instructions against the accounts of all of the issuer's "control" people

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206. *See* text accompanying note 157 *supra*.

207. Landy v. F.D.I.C., 486 F.2d 139, 163 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974); RESTATEMENT (SECOND) OF TORTS § 876 (1976). *See* JENNINGS & MARSH, *supra* note 14, at 1098-99.

208. Landy v. F.D.I.C., 486 F.2d 139, 163 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974).

209. *See* text accompanying notes 82-83 *supra*.

210. *See* text accompanying notes 43-49 *supra*.

211. *See* Official Comments 1 and 4 to U.C.C. § 8-313. *See also* Hoblin and Kelly, *supra* note 7, at 583 & n.10.

212. *See* note 99 *supra*, in which § 12(1) is set out.

and "restricted" security holders, one of whom sells, transfers and delivers his "clean," unlegended certificate to an innocent party prior to any involvement by the transfer agent or issuer. Thereafter, this BFP requests recordation of the transfer. Here, as in the prior discussion, if the transfer agent records the transfer, it ought not be characterized as an aider and abettor of any Section 5 violation, since that violation occurred prior to the transfer agent's involvement;[213] since the transfer agent is motivated to record the transfer by its duty under Sections 8-401 and 8-406 of the U.C.C. rather than by a desire to assist the seller in his Securities Act violation;[214] and since the transfer agent should not be asked to force rescission on an unwilling buyer.

However, in this situation the transfer agent ought not to record the transfer, even though it may have a duty to do so under Sections 8-401 and 8-406 of the U.C.C.,[215] since the issuer has instructed it not to record the transfer and these instructions and the transfer agent's duty under the U.C.C. may, therefore, conflict. In this situation, the transfer agent should bring to the issuer's attention, as it is required to do under agency law,[216] the facts that its instructions are in conflict with the U.C.C. and that liability of both the issuer and transfer agent may result under the U.C.C. from the continued observation of these instructions. If the issuer persists in its instructions, the agent should follow them and look to the issuer for indemnification of any loss suffered by the transfer agent as a result of its failure to fulfill its U.C.C. duties.[217]

However, suppose that while stop transfer instructions with respect to unlegended control or restricted securities are in effect, the transfer agent is requested to record a transfer of these shares prior to their sale to an innocent third party. This would occur, for example, when the securities are not held in one of the forms customarily acceptable for good delivery,[218] and the seller or seller's broker therefore requests that the securities be recorded in the name of the selling broker to facilitate their public sale in the securities markets.

Here the transfer agent has no duty under Section 8-401 to record the transfer immediately, because the written stop transfer instructions lodged with it constitute notice of an adverse claim by the issuer, give rise to a duty of

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213. *See* text accompanying notes 191–92 *supra*.

214. *See* text accompanying notes 206–10 *supra*.

215. Because the transferee requesting recordation of the transfer is here assumed to be a BFP, recordation will likely be mandatory under § 8-401, assuming that the certificates have been properly endorsed and signatures guaranteed. However, since stop transfer instructions imposed by the issuer to prevent Securities Act violations constitute notice to the transfer agent of an "adverse claim," Israels, *Stop-Transfer Procedures and the Securities Act of 1933—Addendum to Uniform Commercial Code—Article 8*, 17 RUTGERS L. REV. 158, 165 (1962); Israels and Guttman, *The Transfer Agent and the Uniform Commercial Code*, 21 BUS. LAW. 981, 988 (1966), the transfer agent may delay the recordation of the transfer while it makes inquiry into the adverse claim. *See* U.C.C. § 8-401(1)(c). However, since it is assumed that the certificate is unlegended and that the holder is a BFP, the transfer agent will be exposed at some point to liability in damages if it fails to record the transfer. Edina St. Bank v. Mr. Steak, Inc., 487 F.2d 640 (10th Cir.), *cert. denied*, 419 U.S. 883 (1974).

216. *See* text accompanying notes 48–49 *supra*.

217. *See* Guttman, *Investment Securities Under the Uniform Commercial Code*, 11 BUFFALO L. REV. 1, 40–41 (1962).

218. *See* note 188 *supra* and accompanying text.

inquiry, and authorize the transfer agent to inquire into the rightfulness of the transfer.[219] Also, if the proposed public sale by the broker on behalf of the seller will violate the Securities Act, the transfer to the broker for which recordation is sought is probably "wrongful,"[220] and, since no BFP is here involved,[221] the transfer agent is under no duty under Section 8-401 to record the requested transfer.[222] Finally, since the "sale" for Securities Act purposes has not yet occurred,[223] the transfer agent is in a position to prevent the Securities Act violation by following its issuer's instructions to refuse to record the transfer.

In this situation, the transfer agent should follow its issuer's instructions and refuse to record the transfer for a number of reasons. First, because the transfer agent is here involved before the securities law violation, is aware of the impropriety of the seller's conduct by virtue of the stop transfer instructions, and has no conflicting duty under the U.C.C. to record the transfer, it will be very difficult for the transfer agent to shield itself from potential aider and abettor liability on the basis previously discussed.[224] Second, adherence to the issuer's instructions is consistent with the transfer agent's duties to the issuer-principal under the law of agency and the U.C.C. Third, the U.C.C. imposes no duty to record the transfer, since it appears to be "wrongful" and not to a BFP.[225]

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219. Israels and Guttmann, *The Transfer Agent and the Uniform Commercial Code*, 21 BUS. LAW. 981, 988–89 (1966); Israels, *Stop-Transfer Procedures and the Securities Act of 1933—Addendum to Uniform Commercial Code—Article 8*, 17 RUTGERS L. REV. 158, 165 (1962).

220. Israels, *How to Handle Transfers of Stock, Bonds and Other Investment Securities*, 19 BUS. LAW. 90, 94 (1963); Israels, *Stop-Transfer Procedures and the Securities Act of 1933—Addendum to Uniform Commercial Code—Article 8*, 17 RUTGERS L. REV. 158, 165 (1962). Note that the transfer of record ownership from the beneficial owner to his broker involves no violation of the Securities Act, and is therefore not "wrongful," since immediately following this event there has been no change in the beneficial (as opposed to record) ownership of the securities. Thus there has been no "offer" or "sale" for Securities Act purposes and no violation of § 5 of that Act. But since the recordation of this transfer could initiate "a chain of events which would ultimately lead to a violation of the Securities Act," Hoblin and Kelly, *supra* note 7, at 591, the transfer might be considered "wrongful."

221. Here the person requesting transfer is the original owner of the securities or his agent (the selling broker) acting on his behalf. Therefore, the person on whose behalf transfer is requested will not be a BFP since he will most likely have been informed of the restrictions on transfer. *See* U.C.C. §§ 8-204, Official Comments 2 & 5, and 8-302(1). *See also* Folk, *supra* note 6, at 1404–05; Israels, *Stop-Transfer Procedures and the Securities Act of 1933—Addendum to Uniform Commercial Code—Article 8*, 17 RUTGERS L. REV. 158, 164 (1962). If the person on whose behalf transfer is requested has actual knowledge of the restriction on transfer, as he most likely will in this situation, such restriction is not rendered ineffective under § 8-204 of the U.C.C. for failure to note the restriction on the certificate. U.C.C. § 8-204 and Official Comment 2.

222. U.C.C. § 8-401(1)(e).

223. The transfer of record ownership from the owner to his broker did not alter the beneficial ownership of the securities, which remains in the original owner until the owner, or his broker, sells the securities on his behalf.

224. In a no-action letter issued to Argus Inc., [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,930 (available November 17, 1978), the staff of the Commission warned:

> that a transfer agent who transfers over a stop required by law, such as a stop on securities issued pursuant to a private placement or intrastate offering under the Securities Act of 1933, could involve the transfer agent and the issuer in a violation of the Federal securities laws. See Rules 146 and 147 under the Securities Act of 1933, 17 CFR 230.146 and 230.147.

225. U.C.C. § 8-401, Official Comment 3. *See* text accompanying notes 78–83 *supra*.

C. *Legended Restricted or Control Securities Which Are Presented After Sale with a Request for Recordation of Transfer*

Legended securities will rarely be presented for recordation because most public trading in securities takes place through brokers and dealers who are members of the National Association of Securities Dealers (NASD).[226] The rules of that Association provide that member brokers and dealers cannot make "good" delivery with legended certificates.[227] Therefore, before a broker will handle a trade for his selling customer, he will require that the legended certificate be exchanged for a clean, unlegended one or that adequate assurances of the timely, future delivery of a clean certificate be made by the issuer or transfer agent.[228] If such an exchange is made, so that the securities are no longer legended at the time of their delivery by the seller or his broker to the buyer, the analysis of the transfer agent's responsibilities is identical to that set out in Part II-B above.[229] If, on the other hand, unlegended certificates are not issued to replace the legended ones, the broker will probably not handle the sale transaction.[230]

Thus, the few cases, if any, in which legended certificates are presented for transfer after sale will be those in which the securities have been sold in negotiated transactions without the intervention of an NASD member. If such a sale is made to a sophisticated, well-informed investor of the type discussed above,[231] who agrees to hold the securities for investment and subject to the terms of the legend, the transaction will be exempt from the registration requirements of the Securities Act under the so-called Section 4 (1 ½) exemption[232] and there will be no Securities Act violation.

While the transfer agent may record such a transfer without fear of Securities Act liability, under Article 8 it will be justified in refusing to record the transfer for a limited period of time while it consults with the issuer about

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226. *See* Hoblin and Kelly, *supra* note 7, at 581–85, for a discussion of the mechanics of public trading through brokers and dealers in the organized securities markets.

227. N. WOLFSON, R. PHILLIPS & T. RUSSO, REGULATION OF BROKERS, DEALERS AND THE SECURITIES MARKETS § 10.06 (1977); *Developments in Private Placements; Distribution of Restricted Securities; Rule 144*, 28 BUS. LAW. 483, 498 (1973); NASD Circular, [1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 78,808 (April 15, 1972).

228. *See* note 212 *supra*.

229. *See* text accompanying notes 181–225 *supra*.

230. *See* N. WOLFSON, R. PHILLIPS & T. RUSSO, REGULATION OF BROKERS, DEALERS AND THE SECURITIES MARKETS, § 10.06 (1977); Israels, *Stop-Transfer Procedures and the Securities Act of 1933—Addendum to Uniform Commercial Code—Article 8*, 17 RUTGERS L. REV. 158, 164 (1962).

231. *See* text accompanying notes 106–07 for a brief discussion of the qualifications of purchasers in so-called "private placements."

232. A holder of restricted securities or a control person can sell his securities privately, without registration under § 5, to purchasers who have the same qualities (wealth, sophistication, and information) as persons who are qualified to purchase from the issuer in a private placement. Such sales are made in reliance on § 4(1), which exempts from § 5 "transactions by any person other than an issuer, underwriter, or dealer." This exemption is available because the private nature of the resale results in the conclusion that no distribution is involved; that being the case, the seller is not an underwriter and is entitled to the 4(1) exemption. *See The Section "4(1-1/2)" Phenomenon: Private Resales of "Restricted" Securities*, 34 BUS. LAW. 1961 (1979). The purchaser in such a transaction will typically sign an investment letter and receive certificates which are legended and subject to stop transfer instructions.

the "adverse claim" which the Securities Act legend comprises.[233] However, once the adverse claim is resolved by instructions from the issuer to record the transfer,[234] the transfer agent will be under a duty to record the transfer,[235] since there is nothing to indicate that the transfer is other than rightful.[236]

If, on the other hand, offers or sales of legended securities are made to members of the public through such negotiated transactions, without compliance with Rule 144, a violation of Section 5 will probably occur.[237] However, in such a situation, that Securities Act violation will be complete at the time the endorsed security is delivered by the seller to the public buyer, and, therefore, for the reasons discussed above,[238] the subsequent recordation by the transfer agent or issuer of the completed transfer cannot "substantially assist" in the perpetration of the Securities Act violation, because that violation was complete before the transfer agent or issuer became involved in the transaction.

Here again, however, the transfer agent will be justified in delaying the recordation of the transfer of the legended security until it has inquired into the adverse claim represented by the Securities Act legend.[239] This it will probably do by asking the issuer, which is the adverse claimant, for instructions.[240] If the transfer by the holder was truly in violation of the Securities Act, the issuer will presumably instruct the transfer agent to refuse to record the transfer, because that instruction is clearly in the issuer's best interest.

If the transfer agent complies with this instruction from its principal, as it must under the law of agency, it will satisfy its duty to its principal without violating its duty under Sections 8-401 and 8-406 of the U.C.C. to the transferee-owner of the security and without aiding and abetting a securities law violation. Because the security was legended its transferee was aware at the time of delivery of the Securities Act problem and was therefore not a BFP;[241] and because the transfer was neither to a BFP nor rightful (because of the violation of the Securities Act),[242] the transfer agent is under no duty to the security owner-transferee to record the transfer under Sections 8-401 and 8-406 of the U.C.C.[243] With respect to the transfer agent's duty to avoid aiding

233. U.C.C. § 8-204, Official Comment 2; H. MARSH, CALIFORNIA CORPORATION LAW & PRACTICE § 7.23 (West 1977).

234. The issuer should give instructions to record the transfer here, since if the "Section 4(1½)" exemption is truly available there will be no Securities Act violation for the issuer to worry about.

235. It is assumed, of course, that the requirements of U.C.C. §§ 8-401(1)(a), (b) and (d) as to endorsements, signature guarantees and tax collection laws are met.

236. U.C.C. § 8-401(1)(e) is satisfied if the transfer is rightful or the transferee is a BFP. Thus, that section is here satisfied, even though the transferee is not a BFP (because of his awareness of the securities law restriction on transfer).

237. *See* text accompanying notes 135–40 *supra*.

238. *See* text accompanying notes 191–205 *supra*.

239. *See* notes 69–76 *supra*, and accompanying text.

240. *See* 1 CHRISTY, *supra* note 1, at § 51.

241. U.C.C. § 8-302(1). *See also* U.C.C. § 1-201(25); U.C.C. § 8-204, Official Comment 5; N.Y. U.C.C. § 8-204, Practice Commentary (McKinney 1964).

242. *See* text accompanying note 72 *supra*.

243. U.C.C. §§ 8-401, Official Comment 3, and 8-406.

and abetting a securities law violation, no claim of aiding and abetting can possibly be raised when, as here, the transfer agent refused to record the transfer.

However, even if the transfer agent records the transfer contrary to the issuer's instructions,[244] it is still strongly arguable, for reasons discussed above,[245] that no aiding and abetting of a Securities Act violation will occur, since the Securities Act violation was completed prior to any involvement by the transfer agent. However, in such a situation where the transfer agent violates its issuer's instructions not to record a transfer of a legended security, the transfer agent will be in breach of its duty to follow the issuer's instructions and of its duty of good faith to the issuer under Section 8-406 of the U.C.C. Thus, the issuer's instructions should be followed in this situation. But if for some reason they are not, the agent, although liable to the issuer, should not be liable for aiding and abetting the securities law violation of the seller which occurred before the agent's involvement.

D. *Presentation of Legended "Restricted" or "Control" Securities to the Transfer Agent Prior to their Transfer, with a Request for Removal of Legends and Stop Transfer Instructions*

At the time the securities are issued in a private placement the issuer will often instruct its transfer agent to stamp the certificates evidencing the securities with a legend indicating that they may not be sold unless the holder has first obtained an appropriate opinion of counsel or no-action letter to the effect that the securities may be sold without compliance with the Securities Act's registration and prospectus delivery requirements.[246] Frequently, the holder of such legended certificates will apply to the transfer agent or issuer, prior to the implementation of any intended transfer of securities, for the removal of the restrictive legend and any related stop transfer instructions,[247] which is effected by cancelling the legended certificate and issuing to the holder a new, clean certificate for the identical number of shares.

A number of things should be noted about such a transaction. First, it may not involve a transfer for purposes of the U.C.C. since there is no

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244. The transfer agent should not disregard its duty to follow its issuer's instructions. If it disagrees with the instructions or otherwise feels unable to carry them out, it should resign. *See* text accompanying note 49 *supra*.

245. *See* text accompanying notes 203–10 *supra*.

246. *See* text accompanying notes 125–28 *supra*. Such legends are usually not imposed on "control" securities (unless acquired in a private placement). *See* U.C.C. § 8-204, Official Comment 5. Instead, stop transfer instructions are placed against such securities and notice of the restriction on transfer is given by the issuer to the security holder. Thus, such a restriction will be effective where the control person is the person requesting recordation of transfer, but not against other transferees without notice of the restriction. U.C.C. § 8-204.

247. *See* 1 CHRISTY, *supra* note 1, at § 51(a). *See also* Kanton v. United States Plastics Inc., 248 F. Supp. 353, 356 (D.N.J. 1965); Riskin v. National Computer Analysts, Inc., 62 Misc. 2d 605, 608–09, 308 N.Y.S.2d 985, 988–89 (Sup. Ct. 1970), *modified*, 37 A.D.2d 952, 326 N.Y.S.2d 419 (1971). The removal of such legends is sought so that sales of the securities can be effected in the public markets, with "good delivery" assured.

assignment of the securities by their owner to a transferee;[248] the securities, now evidenced by a new certificate, remain in the name and possession of the original holder. Second, there is no "offer or sale" of the securities for purposes of the Securities Act since the original holder has not "disposed of the securities for value";[249] rather, he continues to own and hold them, although they are now free of the legend condition to which they were formerly subject. Third, since the request for the removal of the legend precedes the holder's sale and transfer of the securities, that removal may facilitate their public sale,[250] possibly in violation of Section 5 of the Securities Act.

Thus, unlike those situations previously discussed in which the transfer agent becomes involved in the transfer process only after the Securities Act violation has occurred, here the transfer agent is in a position to provide assistance to the holder in perpetrating Securities Act violations. However, because no offer or sale is involved in the removal of the legend, there can be no Securities Act violation in that transaction. Therefore the transfer agent cannot be held liable as an aider and abettor unless its conduct in removing the restrictive legends somehow aids and abets a future violation of the Securities Act by the holder. This could occur only if the transfer agent were aware, at the time that it removed the legends, that the holder would sell the securities in an improper way.[251]

Therefore, when the transfer agent receives, in connection with a request for removal of legends, an opinion or no-action letter which appears on its face[252] to satisfy the conditions of the legend and instructions from the issuer to remove the legend, it can and should do so without fear of incurring liability as an aider and abettor of a future Securities Act violation by the holder. In this situation, the transfer agent has no reason to believe that any future transfer and sale by the holder will violate the Securities Act, since the documentation in its possession now indicates that the legends are no longer required and that future Section 5 violations are no longer a significant possibility. Therefore, the transfer agent should not be characterized as an aider

248. *See* Steranko v. Inforex, 5 Mass. App. Ct. 253, 274, 362 N.E.2d 222, 236 (1977); note 68, *supra*. *Cf.* Kenler v. Canal Nat'l Bank 489 F.2d 482, 485–86 (1st Cir. 1973).

249. Securities Act §2(3), 15 U.S.C. § 77b(3) (1976). *See* Hoblin and Kelly, *supra* note 7, at 589–92.

250. See Kenler v. Canal Nat'l Bank, 489 F.2d 482, 485-86 (1st Cir. 1973). *See also* Hoblin and Kelly, *supra* note 7, at 591.

251. Hoblin and Kelly, *supra* note 7, at 591.

252. Christy's leading treatise advises transfer agents to refrain from "looking behind" the conclusions set out in a legal opinion, but rather to leave to the issuer the question of the adequacy of the opinion or no-action letter. 1 CHRISTY, *supra* note 1, at § 51(a). Attempts by issuers and transfer agents to justify their refusals to record a transfer on the grounds that incorrect conclusions are set forth in the proffered Securities Act opinion or "no-action" letter have usually been unsuccessful. *See, e.g.*, Riskin v. National Computer Analysts., Inc., 62 Misc. 2d 605, 608, 308 N.Y.S.2d 985, 988 (Sup. Ct. 1970), *modified*, 37 A.D.2d 952, 326 N.Y.S.2d 419 (1971); Friedman v. Chemical Bank N.Y. Trust Co., [1964–66 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,519 (N.Y. Sup. Ct. 1965); Donlon Ventures, Inc. v. Avien, Inc., [1966–67 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,961 (N.Y. Sup. Ct. 1967); Doliner v. Eastern Can Co., 62 Misc. 2d 255, 309 N.Y.S.2d 249 (Sup. Ct. 1965). On the other hand, if the proffered opinion letter or no-action letter does not comply with the requirements imposed by the issuer for the removal of the restriction, recordation of the transfer can be refused on the grounds that the opinion is inadequate. *See, e.g.*, Kenler v. Canal Nat'l Bank, 489 F.2d 482 (1st Cir. 1973); Melville v. Wantschek, 403 F. Supp. 439 (E.D.N.Y. 1975).

and abettor of any violations which might occur since it had no awareness at the time that action was taken to remove the restriction of any intended impropriety on the part of the holder.

Even if the request of the holder for removal of the legends were supported only by the issuer's instructions to implement such removal, and not by a no-action or opinion letter, the agent could and should remove the legend without fear of liability as an aider and abettor. Since the legends were originally imposed for the issuer's protection, implicit in the issuer's instruction to remove them is the conclusion that they are no longer necessary because the possibility of future Securities Act violations by the holder is no longer significant. Thus, at the time it removes the legends the transfer agent is not aware, even in general terms, of impending Securities Act violations by the holder.

In addition, the transfer agent has a duty under the law of agency to follow the instructions of its principal, whether or not those instructions are supported by an opinion or no-action letter. Thus, even if a transfer agent has a fear that in removing legends pursuant to its principal's instructions it will facilitate future violations of Section 5 of the Securities Act, its motivation or state of mind in removing the legends is not to help the holder facilitate these violations; rather, its motivation is simply to comply with its duty to the issuer under the law of agency and its duty of good faith to the issuer under Section 8-406 of the U.C.C. Therefore, under the Restatement (Second) of Torts, discussed previously,[253] it can be argued that "substantial assistance" has not been supplied by the transfer agent and that the transfer agent is not an aider and abettor to any future violations, since the transfer agent's "state of mind" or purpose in removing the legends was merely to comply with its duty to the issuer.[254]

In the foregoing situations, it has been assumed that the transfer agent, upon receipt of the request by the holder for the removal of the legends, has consulted with its issuer-principal and been instructed to remove the legends. Suppose, however, that the issuer instructs the transfer agent not to honor the request for removal or, in the alternative, simply refuses to recant its prior instructions that legends be imposed.

In this situation the transfer agent should again comply with its principal's specific or standing instructions by refusing to remove the legends since it has a duty to do so under the law of agency and Section 8-406 of the U.C.C. and since the decision of the issuer to continue the legends in effect indicates the view of the issuer that there remains a significant possibility of Securities

253. *See* text accompanying notes 155–57 and 206–08 *supra*.

254. In addition to the state of mind of the alleged aider and abettor, the Restatement of Torts suggests that three other factors be considered in assessing whether or not "substantial assistance" has been given by the alleged aider and abettor to the perpetrator of the wrong: (1) the amount of assistance given: (2) the presence or absence of the alleged aider and abettor at the time of the wrong; and (3) the relation of the alleged aider and abettor to the wrongdoer. RESTATEMENT (SECOND) OF TORTS § 876 Comment b (1976). *See* Landy v. F.D.I.C., 486 F.2d 139, 163 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974).

Act violations by the holder. Thus, to disregard the issuer's instructions may breach the transfer agent's duty to the issuer and make it an aider and abettor in future Securities Act violations by the holder, since it clearly is aware of the possibility of such violations at the time it disregards the issuer's instructions by removing the legends, thereby facilitating future public sales.[255]

Nor can the transfer agent in this situation necessarily justify its decision to remove the legends, in contravention of its issuer's instructions, on the basis of any duty to do so under the U.C.C. First, since the removal of a legend may not involve a "transfer,"[256] the duty to record transfers under Section 8–401 of the U.C.C. may not arise.[257] Second, even if Section 8–401 is applicable in this situation,[258] the transfer agent is not under a duty to issue the clean certificates under that section, since the person requesting transfer (the original holder) is not a BFP and since the issuance of clean certificates would presumably be "wrongful" if it were to facilitate future Securities Act violations, particularly when the issuance violates specific or standing instructions of the issuer.

Thus, so long as the transfer agent follows the issuer's instructions as to the removal of Securities Act restrictions, there should be no conflict in its duties under the U.C.C., the law of agency, and the Securities Act. Furthermore, if it follows those instructions, it should not be liable as an aider and abettor to its principal or to the holder of the securities.

III. THE COURTS' CONCLUSIONS

The first conclusion to be drawn from the discussion in Part II of this Article is that a transfer agent should rarely, if ever, be held liable as an aider and abettor of a Securities Act violation if it simply follows in good faith its issuer's instructions to record transfers or remove restrictive legends. This conclusion is supported by case law.

Although there are many cases in which it has been alleged or assumed that a transfer agent could, in its normal activities, aid and abet a violation of Section 5,[259] there is no case holding a transfer agent liable under the Securi-

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255. See no-action letter issued to Argus, Inc., [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,930 (available November 18, 1978), which indicates that if a transfer agent records a transfer over a legend or stop transfer instruction imposed by the issuer under Rule 146, it may be an aider and abettor of the future § 5 violation by the holder.

256. *See* note 248 *supra* and accompanying text.

257. Steranko v. Inforex, Inc., 5 Mass. App. Ct. 253, 274, 362 N.E.2d 222, 236 (1977). *Cf.* Kenler v. Canal Nat'l Bank, 489 F.2d 482, 485–86 (1st Cir. 1973).

258. *See* Kenler v. Canal Nat'l Bank, 489 F.2d 482, 486 (1st. Cir. 1973), in which the court assumed, *arguendo*, that U.C.C. § 8-401 was applicable.

259. Melville v. Wantschek, 403 F. Supp. 349, 445–46 (E.D.N.Y. 1975); Charter Oak Bank & Trust Co. v. Registrar & Transfer Co., 141 N.J. Super. 425, 358 A.2d 505 (1976); Branerton Corp. v. United States Corp. Co., 34 A.D.2d 1, 3, 309 N.Y.S.2d 28, 29–30 (1970); Donlon Ventures, Inc. v. Avien, Inc., [1966–67 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,961 (N.Y. Sup. Ct. 1967); Doliner v. Eastern Can Co., 62 Misc. 2d 555, 559, 309 N.Y.S.2d 249, 252–53 (1965). *But see* Wassel v. Eglowsky, 399 F. Supp. 1330, 1367–68 (D. Md. 1975), *aff'd per curiam*, 542 F.2d 1235 (4th Cir. 1976); Kanton v. United States Plastics, Inc., 248 F. Supp. 353 (D.N.J. 1965); Riskin v. National Computer Analysts, Inc., 62 Misc. 2d 605, 608, 308 N.Y.S.2d 985, 988 (Sup. Ct. 1970), *modified*, 37 A.D.2d 952, 326 N.Y.S.2d 419 (1971).

ties Act where its involvement in the transaction was simply as a transfer agent. As the court said in *Wassel v. Eglowsky*,[260] "no case has been cited to or located by this court in which a transfer agent, in the absence of other circumstances, has been found liable for a violation of the federal securities laws."[261]

While an officer of a transfer agent was held liable as an aider and abettor of Securities Act violations in the case of *Securities & Exchange Commission v. International Chemical Development Corp.*,[262] his role as an officer of the transfer agent was only one of a number of roles he played in the transaction. The court carefully pointed out that the officer was not only president of the corporate transfer agent, but also was an officer of one of the corporations involved in the illegal distribution of the securities in question. The court stated, "It is not . . . [the officer's] role as a transfer agent as such that provides liability; it is this activity together with his other actions, including the sales of stock by [the other corporation of which he was an officer], which makes him responsible as an aider in the distribution."[263]

The second conclusion to be drawn from the Part II discussion is that there is no conflict between the duties of the transfer agent under Article 8 of the U.C.C. and under the Securities Act. This conclusion, too, is supported by the results of the existing cases, even though there are opinions which suggest that where a Securities Act violation has occurred or will occur in connection with the transaction, the agent's duty to record the transfer is excused or preempted by the "conflicting" requirements of the paramount federal securities law.[264] However, as will be seen,[265] in such cases the agent's duty to record the transfer in fact never arose under the U.C.C., since the condition that the transfer be either rightful or to a BFP[266] was never satisfied; thus the U.C.C. itself, without preemption by or conflict with the Securities Act, justified the transfer agent's refusal to transfer.

In the one federal appellate case which expressly deals with the issue of the "conflict" between Article 8 and the Securities Act, *Edina State Bank v. Mr. Steak, Inc.*,[267] the Tenth Circuit Court of Appeals held that the Securities

260. Wassel v. Eglowsky, 399 F. Supp. 1330 (D. Md. 1975), *aff'd. per curiam*, 542 F. 2d 1235 (4th Cir. 1976).

261. *Id.* at 1367–68.

262. 469 F.2d 20 (10th Cir. 1972).

263. *Id.* at 35. *See also* SEC v. LesStuds Corp., [1971 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,087 (S.D.N.Y.1971); SEC v. Dumont Corp., [1969–70 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 92,424 (S.D.N.Y. 1969), in each of which a transfer agent was enjoined from further participation in a Securities Act violation. However, in these cases, as in *International Chemical*, the transfer agent's conduct and role went well beyond that of the normal transfer agency, since in each the transfer agent was actively involved in structuring the illegal scheme and in each the agent directly profited from the illegality.

264. *See* Charter Oak Bank & Trust Co. v. Register & Transfer Co., 141 N.J. Super. 425, 434, 358 A.2d 505, 510 (1976). *See also* Branerton Corp. v. United States Corp. Co., 34 A.D.2d 1, 309 N.Y.S.2d 28 (1970); Melville v. Wantschek, 403 F. Supp. 439, 445–46 (E.D.N.Y. 1975).

265. *See* text accompanying notes 297–322 *infra*.

266. U.C.C. § 8-401(1)(e).

267. 487 F.2d 640 (10th Cir. 1974).

Act does not conflict with and does not override Section 8-204[268] of the U.C.C., which provides that restrictions on transfer that are not conspicuously noted on the face of the certificate are ineffective against a person without actual knowledge of them. In that case, a transfer agent refused to record a previous transfer by a pledgee of restricted but unlegended shares, because its issuer, fearing liability under the Securities Act, had instructed it not to record the transfer. The transfer agent complied with these instructions and was then sued for damages under Sections 8-406 and 8-401 of the U.C.C. for failure to fulfill its duty to record the transfer.

The Tenth Circuit held that the transfer agent was liable to the transferee under the provisions of the U.C.C. for its wrongful refusal to transfer the shares since no restriction on transfer was noted on the certificate and since the pledgee had no actual knowledge of the restriction. The court found liability regardless of the fact that the prior sale, which had been rescinded, violated the federal securities laws. The court expressly rejected the holding of the lower court[269] that the Securities Act and Section 8-204 conflict and that the Securities Act overrides the U.C.C. and justifies the transfer agent's refusal to transfer, even though it would otherwise have a duty to do so under the U.C.C. In so holding the court stated:

> We cannot agree that the absence of a requirement for a notation of the restriction in the federal [Securities Act] overrides § 8-204 under the doctrine of preemption. . . . [W]e feel that this important provision of the [U.C.C.] may be read in harmony with the [Securities Act]. Both regulations can be enforced without impairing federal superintendence of the field and thus the state statute need not give way. . . . We feel the Securities Act shows no intent to prevent such significant regulation by state law.[270]

Thus, *Edina* indicates that conflicts between the Securities Act and Article 8 are to be avoided, whenever reconciliation of the two statutes is possible. The discussion in Part II indicates that the two statutes can indeed be read in harmony.

In addition to rejecting the purported conflict between Article 8 and the Securities Act, the court in *Edina* also expressly rejected the transfer agent's argument that it could, if it recorded the transfer, be charged as an aider and abettor under the Securities Act and that this furnished an excuse for its refusal to transfer.[271] This leads to the third conclusion to be drawn from the Part II discussion: since a transfer agent functioning solely as such will not

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268. U.C.C. § 8-204. *See* note 74 *supra.*

269. Edina St. Bank v. Mr. Steak, Inc., Civil No. C-2621 (D. Colo. 1972).

270. Edina St. Bank v. Mr. Steak, Inc., 487 F.2d 640, 644 (10th Cir.), *cert. denied,* 419 U.S. 883 (1974) (footnote omitted).

271. *Id.* at 645. Because the plaintiff-pledgee had sought damages (rather than a mandatory injunction to compel the recordation of the prior sale, which had subsequently been rescinded by the buyer), the court was not faced with the question of "whether the bank here as bona fide pledgee could enforce specifically the transfer of the collateral to the purchaser." *Id.* It should be noted, however, that any Securities Act violation had occurred and was complete before any request for recordation of transfer was made. Thus, recordation of the sale, had it not been rescinded by the purchaser, would not have violated or furthered the violation of the Securities Act.

likely be held to be an aider and abettor under the Securities Act and since there is no inherent conflict between the Securities Act and Article 8, a transfer agent cannot justify its refusal to record a transfer by simply asserting that the transaction is or may be violative of the Securities Act. Rather, the transfer agent must determine that there is a basis for the refusal under Sections 8-401 and 8-406 of the U.C.C., such as the failure of the condition that the transfer be either rightful or to a BFP.

Again the results of the cases support this conclusion, though certain of the opinions do not necessarily do so. In many cases in which recordation of transfer has been requested, issuers or their transfer agents have refused to record the transfer on the grounds that the transfer is or will be violative of the Securities Act. This refusal then leads to a lawsuit by the owner of the securities under Sections 8-401 and 8-406 of the U.C.C. for the wrongful refusal by the issuer or transfer agent to record the transfer.[272]

To the extent that these lawsuits are the subject of reported opinions, their results fall into three categories. In category 1 cases, the plaintiff-security owner prevails, notwithstanding the protestations of the issuer or transfer agent as to their desire to avoid "participating in a Securities Act violation."[273] In category 2 cases, the issuer or transfer agent successfully rebuts the plaintiff's efforts to affix liability on it because conditions, such as appropriate opinions of counsel or no-action letters, imposed by the issuer on the transferability of the securities have not been satisfied.[274] In category 3 are cases in which the issuer or transfer agent again prevails and in which the person requesting transfer appears to be involved in or aware of the Securities Act violation which is claimed to justify the refusal to record the transfer of the securities.[275]

Before briefly discussing the cases in these categories, one major point should be emphasized: Even though it is often alleged by the transfer agent or issuer in these cases that the desire to avoid Securities Act problems justifies the refusal to record the transfer, the courts' conclusion that recordation of transfer is not required (in those cases in which it is not) could also be based

272. *See, e.g.*, Kanton v. United States Plastics, Inc., 248 F. Supp. 353 (D.N.J. 1965); Charter Oak Bank & Trust Co. v. Registrar & Transfer Co., 141 N.J. Super. 425, 358 A.2d 505 (1976).

273. *See, e.g.*, Edina St. Bank v. Mr. Steak, Inc., 487 F.2d 640 (10th Cir.), *cert. denied*, 419 U.S. 883 (1974); Diversified Earth Sciences, Inc. v. Hallisey, [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,055 (S.D.N.Y. 1973); Gasarch v. Ormand Indus., Inc., 346 F. Supp. 550, 552 (S.D.N.Y. 1972); Kanton v. United States Plastics, Inc., 248 F. Supp. 353, 358–59 (D.N.J. 1965); Riskin v. National Computer Analysts, Inc., 62 Misc. 2d 605, 608–09, 308 N.Y.S.2d 985, 988–96 (Sup. Ct. 1970), *modified*, 37 A.D.2d 952, 326 N.Y.S.2d 419 (1971); Donlon Ventures, Inc. v. Avien, Inc., [1966–67 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,961 (N.Y. Sup. Ct. 1967); Doliner v. Eastern Can Co., 62 Misc. 2d 555, 309 N.Y.S.2d 249 (Sup. Ct. 1965); Friedman v. Chemical Bank N.Y. Trust Co., [1964–66 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,519 (N.Y. Sup. Ct. 1965).

274. *See, e.g.*, Kenler v. Canal Nat'l Bank, 489 F.2d 482 (1st Cir. 1973); Petrillo v. Seven Arts Prod., [1966–67 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,921 (N.Y. Sup. Ct. 1967). *See also* Edgar v. Camera Corp. of Am., [1966–67 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,802 (N.Y. Sup. Ct. 1966).

275. Melville v. Wantschek, 403 F. Supp. 439 (E.D.N.Y. 1975); Travis Inv. Co. v. Harwyn Publishing Corp., 288 F. Supp. 519 (S.D.N.Y. 1968); Charter Oak Bank & Trust Co. v. Registrar & Transfer Co., 141 N.J. Super. 425, 358 A.2d 505 (1976); Welland Inv. Corp. v. First Nat'l Bank of Jersey City, 81 N.J. Super. 180, 195 A.2d 210 (1963); Branerton Corp. v. United States Corp. Co., 34 A.D.2d 1, 309 N.Y.S.2d 28 (1970).

on the grounds that the person requesting transfer is not a BFP and that the transfer is wrongful.[276] This conclusion is clearly supported by the fact that the only cases excusing the recordation duty on "securities law grounds" are those in which the person requesting the recordation of transfer appears to have been involved in the Securities Act violation[277] and, therefore, could not be a BFP, since he was not acting in good faith; and those in which the person requesting transfer was aware of (and had not complied with) the restrictions on transfer imposed by the issuer[278] and, therefore, could not be a BFP since he had notice of the "adverse claim." Thus, in these cases the transfer agent's duty to record did not arise under Sections 8-401 and 8-406 of the U.C.C., or was excused, since the transfer in violation of the Securities Act was wrongful and was not to a BFP.

In a category 1 case, *Kanton v. United States Plastics*,[279] the plaintiff, a holder of restricted, legended[280] securities of the defendant, prevailed on his motion for summary judgment on a request for a mandatory injunction compelling the issuer and its transfer agent to record a transfer of the securities from the name of plaintiff to that of his nominee, Torsal Company, presumably to facilitate their public sale by the plaintiff through his nominee. Although the plaintiff had held the securities for three years and had obtained a no-action letter from the Commission and an opinion of counsel, both indicating that the securities could be sold publicly, the issuer and its transfer agent refused to record the transfer because: (1) the "transfer had not been registered under the Securities Act of 1933 [which raises] a question as to whether a transfer could be made on the basis of the 'no-action letter' furnished by plaintiff"; and (2) the issuer or transfer agent is "obliged to take reasonable steps to satisfy itself that it is not participating in a criminal act in permitting a transfer of shares of stock not registered under the Securities Act of 1933 and which bear a legend that the shares are subject to an investment representation."[281] The court, recognizing the difference between a sale under the Securities Act and the recordation of a transfer under the U.C.C., granted the plaintiff's motion for summary judgment because

> [n]either [the issuer nor its transfer agent] points to any provision of the Securities Act of 1933 or the Securities Exchange Act of 1934 that would make them liable to criminal action for registering a transfer of stock. Defendants make reference to section 5 of the 1933 Act, 15 U.S.C.A. § 77e. But that section has nothing to do with stock transfers. It prohibits the sale of securities that are subject to its provisions. It is difficult to envision how the transfer of stock requested by plaintiff in this case would make defendants liable to the penalties prescribed in section 24 of the 1933 Act, 15 U.S.C.A. § 77x, for a willful violation of section 5.[282]

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276. *See* text accompanying notes 297–322 *infra*.

277. *See* note 274 *supra* and text accompanying notes 297–322 *infra*.

278. *See* note 273 *supra* and text accompanying notes 297–301 *infra*.

279. 248 F. Supp. 353 (D.N.J. 1965).

280. The certificates representing most of plaintiff's shares were legended, although the certificates evidencing a minor amount of stock received in a stock dividend bore no restrictive legend.

281. 248 F. Supp. 353, 357–58 (D.N.J. 1965).

282. *Id.* at 358.

The *Kanton* case was discussed in *Diversified Earth Sciences, Inc. v. Hallisey*,[283] in which holders of restricted shares were granted an injunction compelling the issuer to cease interfering with their transfers of shares to the public under Rules 144[284] and 145,[285] which the issuer had refused to record. The court found that the issuer had no reasonable basis for impeding such transfers, subject to the limitations of Rule 144, and therefore granted the requested injunction.

Another case which relies upon *Kanton* is *Gasarch v. Ormand Industries, Inc.*,[286] in which plaintiff, a holder of legended, restricted stock, sought an injunction compelling the issuer and its transfer agent to remove the legends by exchanging new, clean certificates for the legended ones. At the time of his request for the removal of the legends, plaintiff had submitted to the transfer agent a "no-action" letter. The issuer moved to dismiss, on the grounds of lack of personal jurisdiction. In the course of denying this motion the court also discussed the sufficiency of the plaintiff's complaint:

> The complaint states a sufficient claim for relief under New York law against the defendant Morgan [the transfer agent] for wrongful failure to transfer plaintiff's shares. It has been held in New York that submission by a shareholder of an SEC "no-action" letter along with the restricted shares covered by that letter, requires the corporation and its transfer agent to transfer those shares absent a valid reason not to do so. [Citations omitted.] No reason other than the restriction endorsed on the shares has been furnished to warrant refusal of the requested transfer.[287]

In *DeWitt v. American Stock Transfer Co.*,[288] the transfer agent refused to effect recordation of a transfer of more than ten percent of the outstanding stock of an issuer, because of its concern that the transferor, by virtue of the size of his holdings in the issuer's stock, was a control person and that the transaction might violate the Securities Act. Following the failure of the transferee to provide a requested opinion of counsel as to the compliance of the transaction with the Securities Act and his refusal to accept securities that would be subject to restrictions on transferability, the transfer agent refused to record the transaction. This resulted in a lawsuit against the transfer agent seeking some $200,000 in damages. Upon the transfer agent's motion to dismiss, the court held that the plaintiff's claim against the transfer agent stated a viable cause of action and would not be dismissed, but would be subject to a determination at trial as to whether the transfer agent acted "reasonably" in refusing to effect the transfer. Upon rehearing, the District Judge again refused to dismiss the complaint against the transfer agent.[289]

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283. [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,055 (S.D.N.Y. 1973).

284. *See* text accompanying notes 137–45 *supra*.

285. SEC Rule 145, 17 C.F.R. § 230.145 (1981), pertains to securities issued in certain mergers, sales of assets, and other corporate reorganization transactions. Among other things, it imposes upon "affiliates" of the constituent corporations certain limitations on the public disposition of securities received in the reorganization transaction.

286. 346 F. Supp. 550 (S.D.N.Y. 1972).

287. *Id.* at 552.

288. 433 F. Supp. 994, *modified*, 440 F. Supp. 1084 (S.D.N.Y. 1977).

289. 440 F. Supp. 1084 (S.D.N.Y. 1977).

In a number of New York cases—*Friedman v. Chemical Bank New York Trust Co.*,[290] *Doliner v. Eastern Can Co.*,[291] *Donlon Ventures, Inc. v. Avien, Inc.*[292] and *Riskin v. National Computer Analysts, Inc.*[293]—the courts rebuffed attempts by the issuer or transfer agent to avoid recordation of a transfer or removal of a legend on the basis that the Securities Act would be violated by the transfer or removal.[294] In each of these cases the plaintiff, a holder of restricted shares, had obtained a no-action letter indicating that the securities could be publicly sold without violating the Securities Act. But in each instance, the issuer or transfer agent continued to assert its fear that a violation of Section 5 would result from the transaction. Thus, the category 1 cases discussed above suggest that a mere fear by an issuer or transfer agent that a violation of the Securities Act may occur in connection with transfer, the recordation of which has been requested, is not enough to justify holding up the requested recordation, particularly where the holder of the restricted or control securities has obtained a no-action letter.

Of course, if the securities are subject to a restrictive legend, the conditions of which have not been met through the production of either the required opinion or no-action letter in appropriate form, the transfer agent's refusal to record the transfer or remove the legend will usually be justified. In the absence of the required opinion or no-action letter regarding compliance with the Securities Act, it can be assumed that a transfer of the securities that are subject to the Securities Act legend is or will be wrongful;[295] and because of the existence of the legend on the securities, the person requesting transfer will not be a BFP.[296] Therefore, under Section 8-401(1)(e), a transfer agent or issuer may refuse to record a transfer when the conditions of the legend are not satisfied.

Thus, for example, in a category 2 case, *Kenler v. Canal National Bank*,[297] a transfer agent was found to have been justified in refusing to exchange clean certificates for existing, legended ones when the owner failed to submit the required opinion of counsel. Although a no-action letter was submitted by the shareholder in lieu of the opinion of counsel required by the legend, the court found the letter to be different from, and in many respects inferior to, the required opinion. In another case, *Petrillo v. Seven Arts Productions*,[298] the court granted summary judgment in favor of the defendant

290. 62 Misc. 2d 605, 308 N.Y.S.2d 985, [1964–66 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,519 (N.Y. Sup. Ct. 1965).

291. 62 Misc. 2d 555, 309 N.Y.S.2d 249 (Sup. Ct. 1965).

292. [1966–67 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,961 (N.Y. Sup. Ct. 1967).

293. 62 Misc. 2d 605, 308 N.Y.S.2d 985 (Sup. Ct. 1970).

294. Presumably the results of the cases would have been the same if an opinion letter had been obtained instead of the "no-action" letter, since in Kenler v. Canal Nat'l Bank, 489 F.2d 482 (1st Cir. 1973), the court stated that a legal opinion is preferable to a no-action letter as support for a requested transfer.

295. See note 72 *supra* and accompanying text.

296. U.C.C. §§ 8-401(1)(e) and 8-302(1). *See also* U.C.C. § 8-204, Official Comment 5.

297. 489 F.2d 482 (1st Cir. 1973).

298. [1966–67 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,921 (N.Y. Sup. Ct. 1967).

trustee who was sued by a holder of restricted securities for refusing to release clean, unlegended securities to the security holder. However, the trustee prevailed since the agreement between the issuer and the holder provided that clean certificates would be released only upon the satisfaction of certain conditions, one of which was the delivery of the required opinion of counsel addressing the applicability of the Securities Act. Since the required opinion was not produced, issuance of the clean certificates by the trustee was not required.[299]

Of course, if certificates evidencing restricted or control securities are not stamped with a legend, the transfer agent cannot justify its refusal to record the transfer on the basis of the failure to satisfy the requirements of the legend and of Section 8-401(1)(e) of the U.C.C. Thus, in *Edina State Bank v. Mr. Steak, Inc.*,[300] refusal to record a transfer which probably was violative of the Securities Act resulted in the transfer agent's liability in damages when the transferee of the unlegended, restricted shares was innocent. This result is consistent with Section 8-401(1)(e) of the U.C.C., although the *Edina* court did not base its decision on that section,[301] since the transferee appears to have been a BFP at the time he took the unlegended shares in pledge. Therefore, the transfer, even if wrongful, should have been recorded under that section.

In *DeWitt v. American Stock Transfer Co.*[302] a purchaser of unlegended, control securities, who sued the transfer agent for failing to record the transfer, survived the transfer agent's motion to dismiss, even though it was contended by the transfer agent that the transfer to the plaintiff violated the Securities Act and even though plaintiff declined the transfer agent's request for a legal opinion, as well as its offer to issue him legended shares. Again, this result is consistent with Section 8-401(1)(e) since, on the facts, the plaintiff appears to have been a BFP: there was no legend on the transferred stock and so, at the time of purchase, he was not aware of the "adverse claim" of the issuer that the securities were subject to Securities Act restrictions.

In other cases, however, courts have held that transfer agents have been justified in refusing to record transfers of unlegended, restricted or control securities because of the possibility of a Securities Act violation in connection with the transfer.[303] However, the facts in these cases at least raise

299. *See also* Edgar v. Camera Corp. of Am., [1966–67 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,802 (N.Y. Sup. Ct. 1966), in which the court refused to compel the recordation of transfers, even though a Securities Act opinion letter had been produced in an attempt to respond to the requirements of the legend, because it was not clear that the legend was directed *solely* at the prevention of Securities Act violations.

300. 487 F.2d 640 (10th Cir.), *cert. denied*, 419 U.S. 883 (1974). *See* text accompanying notes 267–71 *supra*, for a further discussion of this case.

301. The decision was based on the court's interpretation of § 8–204. 487 F.2d 640, 642–46 (10th Cir.), *cert. denied*, 419 U.S. 883 (1974).

302. 433 F. Supp. 994, *modified*, 440 F. Supp. 1084 (S.D.N.Y. 1977).

303. *See, e.g.*, Melville v. Wantschek, 403 F. Supp. 439 (E.D.N.Y. 1975); Charter Oak Bank & Trust Co. v. Register & Transfer Co., 141 N.J. Super. 425, 358 A.2d 505 (1976); Branerton Corp. v. United States Corp. Co., 34 A.D.2d 1, 309 N.Y.S.2d 28 (1970); Travis Inv. Co. v. Harwyn Publishing Corp., 288 F. Supp. 519 (S.D.N.Y. 1968).

questions as to whether, at the time he acquired the securities, the person requesting transfer was aware of the restrictions on transfer or possibly was a participant in a Securities Act violation. Therefore, while the cases are not decided on the basis of Section 8-401(1)(e) of the U.C.C., again, they are consistent with it, because the person requesting transfer would not, in these circumstances, be a BFP and since a transfer in violation of the Securities Act is wrongful.

In *Melville v. Wantschek*[304] the plaintiff, a holder of restricted securities that were the subject of stop transfer instructions and investment letters signed by him restricting their transfer, proposed to sell them publicly in circumstances that were such that the Commission's staff refused to issue a no-action letter, disagreeing with plaintiff's assertion that the sale would be exempt from the registration and prospectus delivery requirements of the Securities Act. Thus, there was at least a strong possibility that the plaintiff, if he persisted in his plan, would make an illegal distribution. The plaintiff did persist, furnishing legal opinions, prepared by lawyers who were unaware of the position previously taken by the Commission's staff, to support his request that the shares be reregistered in the name of his broker to facilitate their public sale on his behalf. However, the transfer agent, acting on instructions from the issuer, refused to effect the transfer. The Court ultimately concluded that the transfer agent was justified in refusing to record the requested transfer. This conclusion is consistent with Section 8-401(1)(e), since a transfer to facilitate a future Securities Act violation may be wrongful and since the plaintiff appears not to have been a BFP.[305]

In *Branerton Corp. v. United States Corporation Co.*[306] restricted securities, which were apparently not legended, were pledged to secure a loan. Upon default, the pledgee foreclosed and sold the shares to a buyer, who then refused delivery when he found that the shares had not been registered under the Securities Act. At that point, the pledgee corporation transferred the shares to its president, who requested that the transfer to him be recorded. The transfer agent refused, believing that the transfer was violative of the Securities Act. The transferee-president sued to compel recordation of the transfer. The court denied plaintiff's motion for summary judgment, holding that there were triable issues of fact: whether the transfer was violative of the Securities Act and whether the plaintiff had knowledge of the restrictions on transfer. Thus, the result in this case is consistent with, although not based on, Section 8-401(1)(e), since the transfer may have been wrongful and the

304. 403 F. Supp. 439 (E.D.N.Y. 1975).

305. By signing investment letters when he acquired the shares, the plaintiff clearly demonstrated that he had notice of the "adverse claim" at that time; plaintiff also was clearly aware that there was a strong possibility that the sale by him would violate the Securities Act, since the staff of the Commission had refused to issue the requested no-action letter.

306. 34 A.D.2d 1, 309 N.Y.S.2d 28 (1970).

person requesting transfer may not have been a BFP.[307] Summary judgment was denied so that these questions could be reached at trial.

In *Charter Oak Bank & Trust Co. v. Registrar & Transfer Co. Inc.*,[308] a pledgee of unlegended control and restricted shares sought to have them registered in the name of his broker to facilitate their public sale following the pledgor's default. When the transfer agent refused to record the transfer, in accordance with its issuer's instructions, the pledgee sued. The court held that the transfer agent was justified in refusing to record the transfer because,

> when a transfer agent has reasonable cause to believe that a transfer could be in violation of the Securities Act, it has a right to refuse to make the transfer until it has received an explanation or showing that the proposed transfer would not violate the Securities Act. Any state law which would require a transfer by a transfer agent having reasonable cause to believe that the act would be violated or which would create liability on the part of a transfer agent having reasonable cause to believe that the Securities Act would be violated for failure to make a transfer would be in serious conflict with the Securities Act and would violate the supremacy clause of the Constitution.[309]

In this case, however, the pledgee of the shares was clearly aware, at the time of pledge, that the pledgor was a "control person" of the issuer.[310] Therefore, if the pledgee took these shares with a view to their distribution in an unregistered offering, it would not have been acting with "honesty in fact" in the pledge transaction concerned,[311] since an unregistered distribution to the public of control shares violates Section 5.[312] That the plaintiff intended such a distribution is demonstrated by its later conduct in attempting to sell the shares publicly. Thus, it can be argued that the pledgee was not acting in good faith at the time of the pledge since it knew of the control status of the pledged shares and yet intended to distribute them publicly, and therefore was not a BFP.[313] Accordingly, the result in this case is consistent with that which would have been reached under Section 8-401(1)(e) of the U.C.C.,[314] since the person requesting transfer was not a BFP and since the proposed transfer to the public in violation of the Securities Act appears to have been wrongful.

Travis Investment Co. v. Harwyn Publishing Corp.[315] is another case in which following foreclosure a pledgee of control shares sought to sell them

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307. Obviously, it is very likely that the person requesting transfer (who was president of the pledgee) was aware of the Securities Act restriction when he took the shares from his company and therefore would not be a BFP. Whether the recordation of the transfer was required, therefore, would depend upon its "rightfulness." This in turn would depend upon the plaintiff's wealth, sophistication, information, and investment or distributive intent.

308. 141 N.J. Super. 425, 358 A.2d 505 (1976).

309. *Id.* at 434, 358 A.2d at 510.

310. *Id.* at 429, 358 A.2d at 507.

311. *See* U.C.C. § 1-201(19).

312. *See* text accompanying notes 123–27 *supra*. *See also* SEC v. Guild Films Co., 279 F.2d 485 (2d Cir.), *cert. denied sub nom.* SEC v. Santa Monica Bank, 364 U.S. 819 (1960).

313. *See* U.C.C. §§ 8-302(1) and 1-201(19).

314. Although the court referred to U.C.C. § 8-401, the court found that federal law had preempted the field.

315. 288 F. Supp. 519 (S.D.N.Y. 1968).

publicly through brokers and apparently without compliance with the Securities Act. Following inquiries from the Commission the issuer instructed its transfer agent not to record any requested transfer of these shares, and in accordance with these instructions, the transfer agent informed the selling brokers, prior to any sale, that the shares could not be transferred. The pledgee then unsuccessfully sued the transfer agent and the issuer for wrongful refusal to transfer, with the court viewing the refusal to transfer as reasonable and proper in the circumstances. Again, the decision in this case is consistent with Section 8–401(1)(e)[316] since the pledgee may not have been a BFP and the proposed transfer in violation of the Securities Act was wrongful.

That a proposed transfer in violation of the Securities Act would have been wrongful is reasonably clear.[317] Whether or not the pledgee requesting transfer was a BFP at the time of the pledge is also open to question,[318] since the court indicated that there were questions as to the propriety of the conduct of the plaintiff-pledgee in making the loan and taking the shares in pledge.[319] Thus, the plaintiff-pledgee may have lacked honesty in fact at the time of the pledge and thus have failed to satisfy the requirements for BFP status.[320]

Welland Investment Corp. v. First National Bank of Jersey City[321] also involved a foreclosing pledgee of unlegended, restricted shares who sought to have them recorded in its name following the pledgor's default. The transfer agent refused to record the transfer according to instructions by its issuer, who feared that Securities Act liability would result from the transfer, and the pledgee sued both to compel the transfer and to obtain damages.[322] However, the court refused to grant the plaintiff-pledgee's motion for summary judgment, recognizing that the transfer agent might be justified in refusing the transfer if it were to a non-BFP. The court left for trial the question of whether the foreclosing pledgee of restricted shares was in fact a BFP.

IV. A New Duty—Policing for the SEC?

As previously noted,[323] although there are cases suggesting that a transfer agent is justified in refusing to record transfers which may involve a Securities Act violation, there are no cases which hold that a transfer agent has a duty to conduct itself in this way. Nonetheless, members of the staff of the Commis-

316. The U.C.C. was not in effect at the time the pledge occurred. 288 F. Supp. 519, 525 n.2 (S.D.N.Y. 1968).

317. *See* text accompanying note 72 *supra*. *See also* Israels, *How to Handle Transfers of Stock, Bonds and Other Investment Securities*, 19 BUS. LAW. 90, 94 (1963).

318. *See* Hoblin and Kelly, *supra* note 7, at 590.

319. *Id.*

320. *Id.* at n.36.

321. 81 N.J. Super. 181, 195 A.2d 210 (1963). Again, this case arose before the adoption of the U.C.C.

322. If unlegended certificates are presented for recordation of transfer by one who lacks actual knowledge of the Securities Act restrictions on them, failure to record the transfer may result in liability or damages under U.C.C. § 8-204 as well. Edina St. Bank v. Mr. Steak, Inc., 487 F.2d 640, 644 (10th Cir.), *cert. denied*, 419 U.S. 883 (1974).

323. *See* text accompanying notes 259–65 *supra*.

sion and others have sometimes suggested that a transfer agent must police the securities laws by refusing to record transfers of control or restricted securities, if those transfers have violated or would violate the Securities Act.[324] Section 17A(d)(1)[325] of the Securities Exchange Act at least arguably[326] gives the Commission the power to impose such a duty upon transfer agents by rule making. For a number of reasons, however, such a duty should not be imposed except to the very limited extent that it arises, as previously discussed,[327] from the application of aider and abettor principles.

In the first place, a transfer agent is in no position to make the arcane factual determinations necessary to decide what persons are "in control" of a corporation within the meaning of the Securities Act. As was stated by former Commissioner Sommer,[328]

> when so much attaches to the identification of a person within that category ["controlling person,"] it would be most desirable if the identification could be done with certainty and precision. . . . Alas, such is rarely the case with key concepts in the structure of federal securities law, and this is particularly true in the case of the concept of "control." Like so many key notions the imprecise limits of the term have been limned through the painstaking process of rule, interpretation, judicial decision and ad hoc determinations in "no action letters." Out of these there has come no mathematical standard, no slide rule computation, no certain rule which can infallibly guide counsel and client in making this most important determination . . . .[329]

In addition to the fact that leading members of the securities bar confess their inability to apply this concept with confidence, the staff of the Commission, when asked for advice regarding whether a person is "in control" of a corporation, routinely throws up its hands and declines to give such advice.

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324. No-action letter issued to Defrees, Fiske, Voland, Alberts & Hoffman, [1971–72 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 78,745 (available April 12, 1972). *See also* Bell and Arky, *supra* note 7, at 1661.

325. Securities Exchange Act of 1934, § 17A(d)(1), 15 U.S.C. § 78g-1(d)(1) (1976), provides as follows:

> No registered clearing agency or registered transfer agent shall, directly or indirectly, engage in any activity as clearing agency or transfer agent in contravention of such rules and regulations (A) as the Commission may prescribe as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the chapter, or (B) as the appropriate regulatory agency for such clearing agency or transfer agent may prescribe as necessary or appropriate for the safeguarding of securities and funds.

326. The legislative history to Section 17A(d)(1) indicates that:

> The Commission is empowered with broad rule-making authority over all aspects of a transfer agent's activities as transfer agent. (Section 17A(d)(1)(A)). The Committee expects this to include, among other matters, minimum standards of performance, the prompt and accurate processing of securities transactions, and operational compatability . . . by transfer agents with other facilities and participants in the securities handling process.

S. REP. NO. 94–75, 94th Cong., 1st Sess. 57, *reprinted in* [1975] U.S. CODE CONG. & AD. NEWS 179, 236.

While the above excerpt from the committee report does not purport to limit the Commission's authority under Section 17A(d)(1), it does indicate that a primary purpose of that section was to authorize the Commission to regulate mechanical and operational matters, such as turnaround time.

327. *See* text accompanying notes 255–58 *supra*.

328. Sommer, *Who's "In Control"—S.E.C.*, 21 BUS. LAW. 559 (1966).

329. *Id.* at 562–63. *See also* Israels, *Stop-Transfer Procedures and the Securities Act of 1933—Addendum to Uniform Commercial Code—Article 8*, 17 RUTGERS L. REV. 158, 160 (1962). In fact, the drafters of the proposed Federal Securities Code, sponsored by the ALI, regarded the "control" concept as so inherently unworkable as to call for its total abolition in the new Code.

For example, in the letter dated October 4, 1972, issued to the American Society of Corporate Secretaries,[330] the following response was made by the Division of Corporation Finance regarding the identity of control persons for purposes of Rule 144:

> In this regard, it is this Division's position that a person's status as an officer, director, or owner of 10% of the voting securities of a company is not necessarily determinative of whether such person is a control person or member of a controlling group of persons. His status as an officer, director or 10% shareholder is one fact which must be taken into consideration, but, as you recognize, an individual's status as a control person or a member of a controlling group is still a factual question which must be determined by considering other relevant facts in accordance with the test set forth in Rule 405 under the Act. . . .[331]

The almost routine response of the Commission to one seeking advice as to whether a particular person is or is not a control person of a particular issuer is that questions of control involve matters of fact and judgment which are best left to the issuer and its counsel to resolve. To attempt to impose upon transfer agents this task, from which the staff of the Commission itself recoils, would be unjustifiable.

Similarly, the determination of when shares are "restricted"—that is, taken from the issuer or a control person of the issuer "in a transaction or chain of transactions not involving any public offering"[332]—is also one which the transfer agent is not in a position to make. Decisions of this nature must be based upon precise factual data such as the identity and nature of each offeree, the type and content of the materials provided, the manner in which the offering was conducted, and the type and timing of other past or proposed securities offerings.[333] The Commission's staff itself routinely expresses that the issuer and its counsel are best suited to make decisions as to when the "private offering" exemption is available, since they are in a position to have detailed knowledge of the facts.

Second, there is no requirement that stock held by controlling persons of the corporation bear any restrictive legend and no absolute requirement that restricted shares be legended.[334] Therefore, it is probably safe to say that the great majority of certificates representing "control stock" and some of those representing "restricted stock" do not in fact have any such legend. As the court stated in *DeWitt v. American Stock Transfer Co.*,[335] there is nothing in the Securities Act which requires any legend to be put on certificates

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330. [1972–73 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 79,071 (available October 11, 1972). *See also* United States v. Corr, 543 F.2d 1042, 1050 (2d Cir. 1976), in which it is stated that the "determination [of control] is a question of fact which depends upon the totality of the circumstances including an appraisal of the influence upon management and policies of a corporation by the person involved."

331. [1972–73 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 79,071 (available October 11, 1972).

332. SEC Rule 144, 17 C.F.R. § 230.144(a)(3) (1981).

333. *See* SEC Rule 144, 17 C.F.R. § 230.144(a)-(h) (1981).

334. Edina St. Bank v. Mr. Steak, Inc., 487 F.2d 640, 644 (10th Cir.), *cert. denied*, 419 U.S. 883 (1974); DeWitt v. American Stock Transfer Co., 440 F. Supp. 1084, 1087 (S.D.N.Y. 1977). *Cf.* SEC Rule 146(h)(2), 17 C.F.R. § 230.146(h)(2) (1981).

335. 440 F. Supp. 1084 (S.D.N.Y. 1977).

representing control stock. The court also said, "Restrictions on the sale of securities under the Securities Act of 1933 arise by operation of law, often without affording the issuer or his transfer agent an opportunity to legend the shares."[336]

Therefore, absent some action by the Commission to coerce all controlling persons or restricted shareholders to turn in their certificates to have legends placed on them, to assert that the transfer agent has a duty to police the sales of such persons would impose upon it an impossible task. Furthermore, even if the transfer agent is aware that the transferred, unlegended shares it has been asked to record are "control" or "restricted" shares, it will be obligated under the U.C.C. in most cases to record the transfer, since the person presenting the securities for recordation of transfer will often be a BFP-transferee.

In addition, as noted earlier,[337] not all sales by restricted shareholders violate the registration and prospectus delivery requirements of the Securities Act. Private resales and public sales under Rule 144, for example, are permitted. Thus, if the transfer agent were to be asked to police the Securities Act, it would be placed in a position of having to figure out which transfers were proper and which were not. This, of course, it is not in a position to decide, since such judgments involve legal analyses of detailed facts, as to the nature of the offerees, the manner of the offering, the past conduct of the offeror, and like information, which the transfer agent is not in a position to provide.[338] For these reasons it is suggested that the transfer agent's duties with respect to Section 5 of the Securities Act continue to be limited to refraining from aiding and abetting a violation of the Act.

CONCLUSION

Although much has been written about the emerging responsibilities of transfer agents under the Securities Act, the principal duty of the transfer agent continues to be the one which it owes to its principal, the issuer. If the transfer agent in good faith follows its issuer's instructions, it should rarely, if ever, be held liable as aider or abettor of a Securities Act violation; and, if compliance with that instruction results in a wrongful refusal to transfer under Sections 8-406 and 8-401 of the U.C.C., it should be entitled to indemnity from its own principal. On the other hand, if a transfer agent refuses to follow its issuer's instructions and refuses to record a transfer because it wants to volunteer to police the securities laws, it will be exposed to liability under the U.C.C. to the innocent transferees of the securities, and perhaps to its principal under the U.C.C. and the law of agency. Therefore, reconciliation of the various duties of the transfer agent under the law of agency, the U.C.C., and the Securities Act requires consultation with and instructions from the principal and strict compliance with those instructions.

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336. *Id.* at 1087.

337. *See* text accompanying notes 135–36 *supra.*

338. *See, e.g.*, SEC Rule 146(a)-(h), 17 C.F.R. § 230.146(a)-(h) (1981). *See also* Marsh, *Who Killed The Private Offering Exemption? A Legal Whodunit*, 71 NW. L. REV. 470 (1976).